

STATE OF VERMONT  
PUBLIC SERVICE BOARD

Docket No. 6596

Tariff filing of Citizens Communications Company, d/b/a )      Schedule of Hearings  
Citizens Energy Services, requesting a rate increase in the )  
amount of 40.02%, to take effect December 15, 2001 )      *See Appendix A*

Order entered: 7/15/2002

PRESENT: Michael H. Dworkin, Board Chairman  
David C. Coen, Board Member  
John D. Burke, Board Member

APPEARANCES: *See Appendix B*

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## **I. INTRODUCTION AND OVERVIEW**

In this Order, the Public Service Board ("Board") considers a request by Citizens Communications Company ("Citizens" or the "Company") to increase its retail rates by \$10.7 million (or 40 percent), effective for service rendered on or after December 15, 2001. During the course of this proceeding, Citizens conceded several issues which reduced its request to 29 percent or \$7.9 million.<sup>1</sup> After considering all the issues raised by Citizens and the Vermont Department of Public Service ("Department"), we approve a retail rate increase of 17.45 percent (or approximately \$4.8 million), effective for service rendered on or after July 15, 2002.<sup>2</sup> In addition, we approve a service quality plan designed to assure high quality electric service for Citizens' Vermont customers. Finally, today's Order notes that we are deeply troubled by the continuation of Citizens' significant accounting problems. We hereby put the Company on notice that we may well reconsider the appropriate treatment of accounts for which even partial sampling demonstrates unreliability when we review Citizens' compliance with the terms of probation in Docket Nos. 5841/5859.

The rate increase we approve today, while significant, should be viewed in the appropriate context. From 1993 until today (before this Order), Citizens' residential customers' average monthly bills increased less than 2 percent (approximately \$1 per month); this is considerably lower than the 24.43 percent increase in the Consumer Price Index over the same time period. Even after this Order, Citizens' residential customers' average monthly bills will have increased approximately 19.6 percent in the last decade (approximately \$10.92 per month), still measurably less than the increase in the Consumer Price Index over the same time period. In addition, the percent change in Citizens' average bills for residential customers over the last ten years compares favorably with the 1993-2002 percent changes in the average monthly bills of Vermont's two largest electric utilities' residential customers (approximately 20 percent and 29.5 percent, respectively) and matches the percent change in the state average over the same time period. Finally, even after the rate increase we approve today, the average monthly bill for

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1. This amount includes the Company's request for removal of the 5.25 percent return-on-equity penalty imposed by the Board in Docket Nos. 5841/5859. The Board previously ruled in this Docket that it would not consider removal of the penalty in this case.

2. These figures may be adjusted slightly to reflect a compliance filing that we require of the Company. We are providing the parties today, under separate cover, a copy of the Board's detailed reconciliation schedules.

Citizens' residential customers (\$66.79) will still be below the Vermont average (\$73.36), although the Company's residential per kWh rate will be the third highest in the state (which reflects the facts that Citizens serves customers in a very rural part of the state, and that electric utilities' costs per customer tend to be measurably higher in less densely populated areas).

The single largest contested issue in this case relates to Citizens' recovery of its costs for power purchased pursuant to a long-term contract with Hydro-Québec.<sup>3</sup> The Department recommends that we disallow recovery of \$3.8 million of Citizens' costs for this power, contending that the purchase was imprudent and is uneconomic.<sup>4</sup> Citizens argues that we are precluded from considering these recommendations. In today's decision, we:

- Reject Citizens' preclusion claims;
- Do not find that Citizens was imprudent in committing to this long-term purchase of power in the early 1990's;
- Do find that the power purchased through the Hydro-Québec Contract will be uneconomic in the rate year, and that Citizens did not demonstrate offsetting benefits over the total term of the Contract.

Committing to this long-term purchase of power made sense for Citizens in the early 1990's due to circumstances that distinguish it from other Vermont utilities, including:

- The nature of the Company's interconnections with the Hydro-Québec and Vermont transmission systems;
- Citizens' pressing need for firm baseload power; and
- Benefits of the Hydro-Québec Contract power that are specific to Citizens.

Those unique benefits, in combination with other attributes of the Hydro-Québec Contract power, have significantly increased the value of the power to Citizens and its Vermont ratepayers. However, even taking these unique benefits into account, the Hydro-Québec Contract power remains materially more expensive than market power in the expected rate year. As a result, we disallow as uneconomic \$750,000, which is 50 percent of the above-market portion of the Company's costs of the Hydro-Québec Contract power.

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3. This contract is the Firm Power and Energy Contract between the Vermont Joint Owners and Hydro-Québec, originally executed in December of 1987 (the "Hydro-Québec Contract").

4. The total value of this proposed adjustment is \$3.9 million when one includes working capital and tax effects. This represents approximately 40 percent of the Department's recommended adjustments for all reasons.

In Docket Nos. 5841/5859, this Board concluded that the Company's operation of its Vermont Electric Division had been imprudent due to the Company's "long and persistent record of misconduct and mismanagement."<sup>5</sup> In that proceeding our consideration of, and conclusions regarding, the Company's imprudence did not address whether the Company's costs of power purchased under the long-term contract with Hydro-Québec had been imprudently incurred. In concluding today that the Company was not imprudent in its purchases of this Hydro-Québec power, we in no way are modifying our earlier conclusions regarding the Company's imprudence in other areas.

In fact, today's Order finds that there are still significant problems with Citizens' accounting practices. For example:

- Citizens' own inventory conducted during the course of this proceeding showed that the Vermont Electric Division's ("VED") General Plant accounts were overstated by 45 percent;
- Citizens failed to track the amount of time its salaried employees spent on probation-related activities, and failed to charge the costs associated with that time to shareholders rather than to ratepayers;
- Citizens inappropriately charged the Vermont Electric Division for legal costs incurred on behalf of the Arizona Electric Division; and
- Citizens is lacking supporting documentation for over \$125,000 in expenses related to the preparation of its last Integrated Resource Plan.

In Docket Nos. 5841/5859, we found that Citizens' imprudent operation of VED was so egregious as to justify revocation of the Company's license to operate as a public utility in Vermont. However, we refrained from imposing this penalty because we determined that Citizens had committed to make significant changes to its management practices, and was more likely to be able to correct the problems in a cost-effective and expeditious manner than a new owner.<sup>6</sup> Instead, we put Citizens on strict "regulatory probation" under the supervision of a Special Master (Edwin Norse), and required the Company to perform many actions to improve its management of VED, including undertaking audits of some of its plant accounts, and making

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5. Docket Nos. 5841/5859, Order of 6/16/97 at ii.

6. Docket Nos. 5841/5859, Order of 6/16/97 at iv-v, 282-284.

a variety of changes to its accounting practices.<sup>7</sup> In addition, we imposed a return-on-equity penalty of 525 basis points (one-half the rate of return on equity that otherwise would have been appropriate in that docket, from 10.5 percent to 5.25 percent.)<sup>8</sup>

Today's Order does not change any of the penalties or requirements we imposed on Citizens in Docket Nos. 5841/5859; this docket is not the appropriate context to consider any such modifications. Nevertheless, we are deeply troubled that Citizens' accounting problems are continuing today, despite the fact that *five years* have passed since we originally ordered Citizens to correct its management of VED. These problems have potentially serious implications for Citizens' compliance with the terms of probation, and we will consider the appropriate consequences for Citizens when we review the Company's probationary status and the continuation of the 525 basis-point reduction in Citizens' return on equity in Docket Nos. 5841/5859.

In addition, our Order today provides customers with significant benefits through a new service quality plan for Citizens. We have previously found that benefits to customers of other electric utilities with similar plans include: (1) more comprehensive service monitoring practices; (2) supplying public information on the level of service a company is providing; (3) the provision of data that can be used to make comparisons between utilities; (4) the establishment of a database which can be used to set future, more stringent targets; (5) fee waivers for missed service appointments; and (6) expected financial penalties in the plan to be adopted after two years.<sup>9</sup> As a result of today's Order, these benefits will now also be provided to Citizens' Vermont customers.

## **II. PROCEDURAL HISTORY**

### **Procedural History**

On October 31, 2001, Citizens filed a petition, prefiled testimony, and revised tariff sheets with the Board requesting an increase in the retail rates charged by VED in the amount of

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7. Docket Nos. 5841/5859, Order of 6/16/97 at 307 (Order Paragraphs 2 and 3); Docket Nos. 5841/5859, Order of 9/15/98 at 62–73 (Order Paragraphs, *generally*).

8. Docket Nos. 5841/5859, Order of 6/16/97 at 300–301, 304–306.

9. Docket Nos. 6460/6120, Order of 6/26/01 at 45.

40.02 percent (a revenue increase of \$10,711,972), to take effect on a service-rendered basis commencing December 15, 2001 (Tariff Filing No. 4652). Citizens further requested that if the Board were to suspend the rate filing, it grant the Company a temporary rate increase of 16.91 percent (a revenue increase of \$4,730,118), effective December 15, 2001, and subject to refund based on the outcome of the permanent rate increase proceeding.

On November 29, 2001, the Department, pursuant to 30 V.S.A. § 225, informed the Board that it had reviewed the filing and recommended that it be suspended and investigated.

By Order entered December 5, 2001, the Board suspended the rate filing and scheduled a prehearing conference and preliminary hearing to deal with the temporary rate request. A prehearing conference was held on December 19, 2001, and a Procedural Order was issued on January 9, 2002. A preliminary hearing on the temporary rate request was also held on December 19, 2001, and on January 16, 2002, the Board issued an Order denying the temporary rate increase.

The Docket proceeded according to schedule with discovery during the winter and technical hearings on April 5 through April 11 and May 20 through May 24, 2002. Public hearings were held on February 19, 2002, in North Hero, Vermont, and on February 20, 2002, in Newport, Vermont.

During the course of this proceeding, the Board ruled on various objections and other motions presented by the parties. These rulings need not be restated here, except for the Board's ruling on one issue that has had a direct impact on the level of rates that we approve today. In its original testimony and tariff schedules Citizens included a request that the Board remove the return-on-equity penalty imposed in Docket Nos. 5841/5859. On January 3, 2002, the Department submitted a Motion in Limine requesting the Board to remove this issue from the case. On January 14, 2002, Citizens submitted a Memorandum in Opposition to the Department's Motion, and on January 23, 2002, the Board issued an Order granting the Motion in Limine and deferring the return-on-equity penalty issue until the probation review that will take place in Docket Nos. 5841/5859. On March 6, 2002, in response to a Motion for Clarification filed by Citizens, the Board issued a further Order clarifying that any rate adjustment associated with the lifting or modification of the return-on-equity penalty will occur only in the context of a rate proceeding.

### **III. POSITIONS OF THE PARTIES**

#### **Citizens**

Citizens' original filing requested a 40.02 percent increase in rates, equivalent to \$10,711,972 in incremental revenues. During the course of the current proceeding, the Company conceded several issues that, together, modified its requested increase to \$7,890,525 (equivalent to a 29.09 percent increase). Citizens claims that VED's current revenues fail to cover its cash operating expenses, forcing Citizens' profitable units to provide funding for VED's capital expenditures, operations and maintenance costs, and not allowing for any return on investment.<sup>10</sup>

A significant portion of the requested rate increase is due to increased power purchase costs pursuant to a long-term power contract with Hydro-Québec. The Company asserts that in 1991, when the contract was signed, it was neither physically feasible due to transmission constraints, nor economic, for VED to purchase its baseload power needs from domestic resources.<sup>11</sup> Further, the Company argues that the ongoing relationship with Hydro-Québec offers unique benefits to Citizens, including the availability of secondary products, wheeling revenues, avoided costs and environmental benefits. Accordingly, Citizens argues that all of the costs associated with this power contract should be recovered in rates.

#### **The Department**

The Department is recommending Citizens be granted a rate increase of no more than 3.39 percent (equivalent to a \$932,072 increase in revenues). The Department contends that in the spring and summer of 1991, Citizens failed to adequately monitor changing market conditions, failed to investigate alternative resources for its power needs, and ultimately failed to do the analysis which would have resulted in a decision not to lock into the long-term power contract with Hydro-Québec.<sup>12</sup> According to the Department, these mistakes resulted in Citizens' imprudent decision to lock into that contract. Thus, the Department contends there

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10. McCarthy pf. at 14.

11. Citizens Brief at 8.

12. Department Brief at 3–5.

should be a full disallowance of the imprudent portion of the contract's power costs, equivalent to \$3.8 million.

In addition to the imprudence disallowance, the Department contends that power costs must be adjusted for the above-market cost of power purchased pursuant to the long-term contract with Hydro-Québec. According to the Department witnesses, the rate year cost of replacement power for this contract would be significantly lower than the cost of power purchased under the contract.<sup>13</sup> Traditional ratemaking suggests that these uneconomic costs be shared between ratepayers and equity holders.

The Department is also contesting a number of other items in Citizens' proposed cost of service, the most significant of which are legal, regulatory and consultant expenses, and the treatment of PCB clean-up costs.

#### Disputed Adjustments

The table on the following page summarizes the disputed adjustments we resolve in this Order:

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13. Chernick pf. at 9, 47.

<b>Impact of Disputed Adjustments on Citizens' Proposed Cost of Service</b>						
Using Current Base Revenues of \$27,367,149 and Revenue/Tax Conversion Factor of 1.735716						
Section No. <sup>14</sup>	Adjustment Description	Cost of Service Disputed \$	% of Current Base Revenues	Rate Base <sup>15</sup> Component Disputed \$	Total Disputed \$	% of Current Base Revenues
IV	Issues Associated with the Hydro-Québec Contract	(3,800,000)	13.89%		(3,800,000)	13.89%
V.D	Depreciation Expense	(77,360)	0.28%		(77,360)	0.28%
VI.	DSM and ACE	(45,692)	0.17%	(20,382)	(66,074)	0.24%
VII.A	IRP Costs	(25,302)	0.09%	(11,287)	(36,589)	0.13%
VII.B	PCB Costs	(187,458)	0.68%	16,026	(171,432)	0.63%
VII.C	Hydro-Québec Arbitration Costs	(56,744)	0.21%	(50,624)	(107,368)	0.39%
VII.D &						
VII.E	Docket Nos. 6332 and 6596 Costs	(67,950)	0.25%		(67,950)	0.25%
VII.F	1999 Storm Costs	(101,294)	0.37%	(45,185)	(146,479)	0.54%
VIII.A	Reserve for Storm Costs	(10,000)	0.04%	558	(9,442)	0.03%
VIII.B	Legal, Regulatory and Consultant Costs	(166,051)	0.61%		(166,051)	0.61%
VIII.C	Probation Payroll Costs	(53,453)	0.19%		(53,453)	0.19%
VIII.D	Test-Year Revenues	(386,612)	1.41%		(386,612)	1.41%
	Tax Effect of Items Labeled Above <sup>16</sup>	(2,911,876)	10.64%		(2,911,876)	10.64%
	<b>Total</b>	<b>(\$7,889,792)</b>	<b>28.70%</b>	<b>(\$110,894)</b>	<b>(\$8,000,686)</b>	<b>29.23%</b>
	Other Rate Base Adjustments					1.46%
	<b>Total</b>					<b>30.69%</b>

14. This column refers to the section in this Order where we discuss the disputed adjustment.

15. This column includes the effect on Citizens' cost of service of the rate base component associated with this item. Most of the items with a rate base component are deferred costs which the Company is recovering over a number of years. The unrecovered portion of the costs may or may not be included in rate base; the Company earns a return on the costs if they are included in rate base.

16. This is not a decisional item. Rather, it is a calculated item that results directly from the parties' other contested items.

#### **IV. ISSUES ASSOCIATED WITH THE HYDRO-QUÉBEC CONTRACT**

##### **A. Background**

###### **Findings**

1. In December of 1987, the Vermont Joint Owners and Hydro-Québec executed the Hydro-Québec Contract by which the Vermont Joint Owners purchased a long-term supply of firm power and energy. Citizens was not one of the Vermont Joint Owners and was not a party to the Hydro-Québec Contract.<sup>17</sup> Subsequently, the Vermont Joint Owners made their purchase of power under the Hydro-Québec Contract available to other Vermont utilities through the Hydro-Québec Participation Agreement Amended and Restated as of August 31, 1988 ("Participation Agreement"). Citizens is one of the signatories ("Participants") of the Participation Agreement. Exh. CCC-20; exh. CCC-21.

2. The Vermont Joint Owners and Hydro-Québec executed a Waiver and Release on April 30, 1991. Exh. CCC-JEM-1 (the "Waiver and Release").

3. The Waiver and Release provided that the Vermont Joint Owners and Hydro-Québec mutually agreed to extend from April 30, 1991, until December 1, 1991, their respective rights under the Hydro-Québec Contract to walk away from the Contract without penalty. Exh. CCC-JEM-1.

4. On August 29, 1991, the Vermont Joint Owners and Hydro-Québec exchanged letters that terminated the Waiver and Release, and thus had the effect of "locking-in" the Hydro-Québec Contract. McNeil reb. pf. at 2, 4–7; tr. 5/24/02 at 34–35, 72–73, 86–87 (McNeil).

##### **B. Motion to Strike**

On April 1, 2002, Citizens filed Objections to and Motion to Strike Testimony Related to Hydro-Québec ("Motion to Strike"). In its filing, Citizens sought to bar the Department from presenting testimony on (a) the prudence of the Hydro-Québec Contract, (b) the economic usefulness of the Hydro-Québec Contract, and (c) whether environmental credits should be

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17. At that time, the Vermont Joint Owners were: Allied Power and Light Company; City of Burlington Electric Department; Central Vermont Public Service Corporation ("CVPS"); Franklin Electric Light Company, Inc.; Green Mountain Power Corporation ("GMP"); Village of Johnson Electric Light Department; Rochester Electric Light & Power Company; Vermont Electric Generation & Transmission Cooperative, Inc.; and Vermont Public Power Supply Authority. Exh. CCC-20.

attributed to the Hydro-Québec Contract. Citizens contends that such testimony is barred under the doctrines of collateral estoppel and laches.<sup>18</sup>

Citizens contends, first, that its prudence as a Participant (rather than as one of the Vermont Joint Owners) has been previously established by the Board, and that collateral estoppel bars relitigation of its prudence. In particular, Citizens asserts that in Docket No. 5330, the Board conditionally approved the Participation Agreement, requiring each Participant to justify its respective allocation of the Hydro-Québec Contract power. Then, according to Citizens, in Docket No. 5330-A the Board "gave final and unconditional approval to Citizens' allocations under the Participation Agreement."<sup>19</sup> Furthermore, Citizens asserts, in the Order in Docket No. 5330-A, issued in February 1992, "the Board expressly determined that Citizens' allocation of [Hydro-Québec Contract] energy and power was economic, particularly in comparison to alternative resources, and beneficial to its ratepayers and to the State of Vermont."<sup>20</sup>

As an additional basis for its assertion that the prudence and economic usefulness of its Hydro-Québec Contract power cannot be relitigated, Citizens points to rate proceedings that occurred subsequent to the Board's approval of the Participation Agreement. Citizens claims that in those rate proceedings, the Department did not challenge the Company's recovery of Hydro-Québec Contract power costs, and the Board found as just and reasonable rates that reflected Citizens' Hydro-Québec Contract costs. Consequently, the Company claims that relitigation of its recovery of Hydro-Québec Contract costs is barred by the doctrine of collateral estoppel, and that because the Department has waited so long to challenge Hydro-Québec Contract cost recovery, its challenge should be barred under the doctrine of laches.

In its Motion to Strike, Citizens next claims that the Board has previously recognized that the Hydro-Québec Contract has environmental benefits, not only in the Board's initial approval of the Contract (Docket No. 5330) but also in more recent rate proceedings involving Green Mountain Power Corporation (Docket Nos. 5983 and 6107) and Central Vermont Public Service

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18. Because there was insufficient time to resolve the issues presented in the Company's Motion to Strike prior to the start of evidentiary hearings (which began on April 5), we took the motion under advisement, to be resolved after the hearings. We thus review and rule upon the motion in today's Order.

19. Citizens' Motion to Strike at 6.

20. Citizens' Motion to Strike at 6–8.

Corporation (Docket Nos. 6120/6460). Citizens contends that as a consequence of these prior determinations, the Department and Board should be estopped from revisiting the issue of the environmental benefits of the Hydro-Québec Contract.

Finally, in its Motion to Strike Citizens asserts that the Department's claim that the Company's Hydro-Québec Contract power purchases are not economically useful is based on essentially the same test that the Board rejected in a 1994 CVPS rate proceeding (Docket Nos. 5701/5724). Citizens contends that while the Board has more recently accepted the Department's claim that Hydro-Québec Contract power fails a test of economic usefulness, the Vermont Supreme Court has determined that there is no meaningful difference between the Department's current articulation of its economic usefulness test and the version rejected by the Board in 1994. *See In re Tariff Filing of Central Vermont Public Service Corporation*, 769 A.2d 668, 683–687 (Vt. 2001). Citizens asserts that because the Board has previously rejected the Department's test of economic usefulness, both the Department and the Board are precluded from applying that test in the current proceeding.

On April 18, 2002, the Department filed a Reply in Opposition to Citizens' Motion to Strike. The Department contends that prudence of Citizens' Hydro-Québec Contract purchases has not previously been litigated or decided. More specifically, the Department argues that the Section 248 proceedings cited by Citizens all predated August 28, 1991, which is the date on which the Department contends the Vermont utilities acted imprudently in "locking in" the Hydro-Québec Contract.<sup>21</sup> The Department further contends that there was an agency relationship between the Vermont Joint Owners and the Participants, such that any imprudence by the Vermont Joint Owners can be attributable to Citizens.

As for the Company's claim that the economic usefulness of its Hydro-Québec Contract purchases cannot be litigated in the current proceeding, the Department asserts that the Vermont Supreme Court's decision in *In re CVPS* does not amount to a wholesale rejection of the Department's economic usefulness test. Instead, according to the Department, the Court only addressed whether a prior Board ruling on the used-and-usefulness of CVPS's Hydro-Québec

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21. The Department notes that the Board has previously stated that the evidence presented in Docket No. 5330-A (in which the Board's Order was issued on February 12, 1992) was outdated. The Department, citing the Board Order in Docket No. 5983, asserts that had any Vermont Joint Owner or Participant submitted current information, the result of Docket No. 5330-A may have been different.

Contract costs precluded further litigation of that issue in a subsequent rate case. Thus, the Department contends, the Vermont Supreme Court decision only addressed whether the economic usefulness of *CVPS's* Hydro-Québec Contract costs could be relitigated.

The Department also opposes Citizens' attempted application of "nonmutual offensive collateral estoppel" against state agencies. The Department points out that the Vermont Supreme Court has noted with approval the United States Supreme Court's decisions on the use of defensive and offensive collateral estoppel in private, civil litigation. But, the Department observes, there appears to be no law in Vermont on the use of nonmutual offensive collateral estoppel against a state agency. The Department asserts that the United States Supreme Court has concluded that the doctrine should not be asserted against the federal government, for reasons of public policy. The Department contends that the same policy reasons apply here.

The Department next disputes the Company's claim that the environmental benefits of the Hydro-Québec Contract cannot be litigated. While acknowledging that the Board has previously determined that the Contract does have some environmental benefits, the Department asserts that the Board has never quantified those benefits, and that it is Citizens itself that in its testimony has raised the issue of that quantification.

The Department also contends that, even if the elements of collateral estoppel were satisfied, the Board can and should decline to apply estoppel for policy and practical reasons. The Department asserts that failure to consider the prudence of Citizens' Hydro-Québec Contract purchases may result in the Company's Vermont ratepayers paying millions of dollars of imprudent costs, which would contravene public policy. Instead, according to the Department, Citizens' shareholders should bear such costs, as they have accepted the risk of disallowance of imprudently incurred costs.

Finally, the Department argues that laches does not bar consideration of the Company's Hydro-Québec Contract costs. The Department contends that the equitable defense of laches is unavailable to Citizens because Citizens itself has created the problem that it claims to justify the application of laches: the Company's asserted inability to defend its actions due to management turnover in the time that has ensued since the allegedly imprudent action. The Department asserts that it was unreasonable for Citizens not to expect a prudence review at *some* time during the 30-year term of the Hydro-Québec Contract, and that the Company should have taken steps

to protect against institutional memory drain, including documenting the prudence and used-and-usefulness of its decisions. According to the Department, in light of the Company's failure to take such steps, the equities point squarely to the Company, not its ratepayers, as the party that must bear the consequences of that failure.

The Department also contends that Citizens' laches argument amounts to no more than the *res judicata* arguments that CVPS and GMP have previously raised, and the Board and Vermont Supreme Court have previously rejected. The Department points to Board and Supreme Court precedent to support its position that the Department has discretion to select the timing and the proceeding for challenging a particular utility cost.

On May 7, 2002, Citizens filed a Reply to the Department's Opposition. In its Reply, the Company renews its argument that laches applies, because the Department should have challenged the Hydro-Québec Contract costs in the four prior Citizens' rate cases if the Department believed those costs were not just and reasonable.

The Company continues to assert that collateral estoppel applies, because its Hydro-Québec Contract costs have been included in approved rates four times subsequent to the "lock-in." Citizens further contends that the fact that its other regulatory approvals were issued prior to the lock-in is of no import, because Citizens as a Participant (and not a Vermont Joint Owner) could not have prevented the lock-in.<sup>22</sup>

Citizens disputes the Department's claim that the imprudence of the Vermont Joint Owners should be imputed to Citizens. According to the Company, the lock-in decision was outside the scope of the Vermont Joint Owners' agency relationship with Citizens and the other Participants. The Company also contests the Department's claim that Citizens imprudently failed to at least attempt to influence the lock-in decision. The Company asserts that any such attempt would have been futile, and that it is pure speculation to point to this alleged failure as the proximate cause of the allegedly excess costs of Hydro-Québec Contract power.

Citizens next contends that the Department has already had its full and fair opportunity to litigate the appropriateness of its economic used-and-useful test, and is bound by the Board's rejection of the test in the 1994 CVPS rate case (Docket Nos. 5701/5724). The Company asserts

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22. The Company also argues that any contention that it was imprudent for entering into the Participation Agreement is not before the Board and, anyway, is barred.

that the subsequent Vermont Supreme Court preclusion decision "had to do with the rejection of the test itself,"<sup>23</sup> and was not limited to the specifics of the CVPS rate proceeding. The Company further argues that the Vermont Supreme Court has held that collateral estoppel can be applied against the government, and that it has fully recognized nonmutual offensive collateral estoppel. Citizens asserts that the Department is misguided for relying on the public policy reasons articulated by the United States Supreme Court for not applying nonmutual offensive collateral estoppel to the *federal* government; citing precedent from other states and the Second Circuit, the Company contends that those policy reasons do not apply to the Department.

Citizens argues that public policy considerations support the application of preclusion doctrines, because the Department has previously litigated, or had the opportunity to litigate, the issues related to recovery of Hydro-Québec Contract power costs, and because continued relitigation of these issues will have adverse consequences for the financial health of Vermont's utility industry.

### Discussion

Citizens' preclusion arguments can be summarized as follows:

- The doctrine of collateral estoppel bars litigation of the prudence of Citizens' Hydro-Québec Contract costs because that issue has previously been litigated in Section 248 proceedings;
- The doctrine of collateral estoppel bars litigation of the prudence of Citizens' Hydro-Québec Contract costs because that issue has previously been determined through the inclusion of the costs in prior approved rates;
- The doctrine of collateral estoppel bars litigation of whether the Hydro-Québec Contract has environmental benefits because the Board has previously decided that issue;
- The doctrine of collateral estoppel precludes the Department's proposed economic used-and-useful test because that test has previously been rejected by the Board;
- The Department could have and should have raised its challenge to Citizens' Hydro-Québec Contract costs in a prior rate proceeding, and is barred from doing so here by the doctrine of laches.

We will first address the Company's collateral estoppel claims, and then its laches argument.

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23. Citizens' Reply at 5.

## **1. Collateral Estoppel**

The Vermont Supreme Court has explained that the doctrine of collateral estoppel:

bars the relitigation of an issue, rather than a claim, that was actually litigated by the parties and decided in a prior case. The elements of collateral estoppel are: (1) preclusion is asserted against one who was a party in the prior action; (2) the same issue was raised in the prior action; (3) the issue was resolved by a final judgment on the merits; (4) there was a full and fair opportunity to litigate the issue in the prior action; and (5) applying preclusion is fair.

In re CVPS, 769 A.2d at 673 (citations omitted).

### **a. Collateral Estoppel and Prudence**

We have reviewed the prior Section 248 proceedings and rate cases cited by Citizens, and conclude that the prudence of Citizens' Hydro-Québec Contract purchases was not raised, considered, or determined in any of the cases, as we further discuss in the following sections.

#### *i. Section 248 Proceedings*

As we stated in Docket No. 5983, our Section 248 approval of the Hydro-Québec Contract did not include a review of the prudence of the Contract.

In the Docket 5330 § 248 review, we considered whether the Contract should be approved, not as a general matter, but under specific enumerated criteria. These criteria — including section 248(b)(2) and (b)(4) — do not mandate a prudence review. A § 248 review is concerned with certification of a potential obligation that a utility will undertake. It neither directs the utility to choose to undertake the obligation, nor does the Board assume any managerial status by virtue of having issued a CPG.

A prudence review, on the other hand, determines whether a utility's management decisions, based upon what it knew or should have known, were reasonable in light of all the circumstances that existed at the time the actions in question were taken. If the Company was aware of, or should have been aware of, material information that was not disclosed to the Board, or if prudent managers should have considered relevant matters outside the scope of section 248, it is obvious that a section 248 approval cannot substitute for a prudence determination. Moreover, it does not supplant the responsibility that management has to respond to changing circumstances even after a section 248 approval is granted: a utility's obligations include continued monitoring, review, and

assessment of participation in power projects, and, this continuing review and assessment process needs to be documented "so that its prudence can be evaluated when challenged."

In this Docket [No. 5983] parties have challenged the prudence of GMP's negotiation and structuring of the Contract. Those parties also have focused upon the prudence of GMP's contract management throughout 1991, including the decision to lock-in. Although much of the evidence in Docket 5330 may be relevant to a prudence review of the Contract, we did not review the prudence of the Contract when conducting the 5330 proceeding.<sup>24</sup>

For these same reasons, the Board's review and approval of the Participation Agreement in Docket No. 5330 did not include any review or determination of the prudence of that Agreement.

Similarly, our review in Docket No. 5331, in which the Board approved Citizens' proposed construction of transmission facilities designed to facilitate delivery of power under the Hydro-Québec Contract and the Participation Agreement, did not involve any review of the prudence of Citizens' purchase of that power. Instead, Docket No. 5331 focused on whether the proposed transmission facilities satisfied the criteria of 30 V.S.A. § 248.

More fundamentally, as we also noted in Docket No. 5983, the evidentiary proceedings in Docket No. 5330 concluded more than one year before the August 1991 lock-in. The same is true for Docket No. 5331. Thus, the prudence of the early lock-in could not have been decided in those proceedings.

While the Order in Docket No. 5330-A was issued after the lock-in, the hearings in that proceeding were completed more than five months prior to the lock-in, and the lock-in was not litigated or reviewed. Instead, that proceeding reviewed only the Participant shares of the Hydro-Québec Contract power. Indeed, Docket No. 5330-A was opened specifically as a "compliance docket, for purposes of considering whether any Participation Agreement entitlements should be reallocated as contemplated by Condition No. 7 [of the Board's Order in Docket No. 5330]."<sup>25</sup> Furthermore, Docket No. 5330-A focused on only one of the Section 248

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24. Docket No. 5983, Order of 2/27/98, at 14–15 (footnotes omitted).

25. Docket No. 5330-A, Order of 2/12/92, at 5; *see also id.* at 10, 14–15. Condition No. 7 was included in the Board's Order of October 12, 1990, in Docket No. 5330, and was amended by Order of January 7, 1991, in that same Docket. As amended, Condition No. 7 provided:

Within sixty days all parties to the Participation Agreement shall file statements of their positions

(continued...)

criteria, Section 248(b)(2), given that the Board had concluded in Docket No. 5330 that the proposed allocations of Hydro-Québec Contract power were consistent with all other Section 248 criteria.<sup>26</sup> Section 248(b)(2) addresses only whether the proposed resource:

is required to meet the need for present and future demand for service which could not otherwise be provided in a more cost effective manner through energy conservation programs and measures and energy-efficiency and load management measures . . . .

Consequently, the issues considered in Docket No. 5330-A and the prudence issues that the Department has raised in the present proceeding are not the same, and Docket No. 5330-A does not preclude consideration of those prudence issues in this proceeding.

For these reasons, we conclude that the prudence of Citizens' Hydro-Québec Contract purchases was not previously determined in the Section 248 proceedings.

*ii. Prior Rate Cases*

We likewise reject the Company's claim that its Hydro-Québec Contract costs have already been determined to be prudent because they have been included in rates that the Board found to be just and reasonable. The prudence of Citizens' Hydro-Québec Contract costs has not been explicitly litigated in any of Citizens' prior rate cases. Nonetheless, the Company contends that by allowing its Hydro-Québec Contract costs to be recovered in rates, the Board has tacitly found those costs to be prudently incurred. This argument has been addressed and rejected by

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25. (...continued)

as to whether re-allocations among Vermont utilities of purchases under the [Hydro-Québec] Contract are desirable. Such statement shall include prefiled testimony and exhibits demonstrating that the preferred allocations promote the general good of Vermont in accordance with the criteria and requirements of Section 248 of Title 30, Vermont Statutes Annotated. All parties wishing to comment upon those statements shall do so within thirty days thereafter. Each party shall propose a schedule for hearings and briefs upon this question at the time of its filing. In such proceedings, each Participant (except Burlington Electric Department and Central Vermont Public Service Corporation) shall submit additional justification on how their respective allocations of Contract power under the Participation Agreement meet the present and future need for service that could not otherwise be met more cost-effectively through energy conservation, energy efficiency and load management measures. If the Board determines that any such Participant is entitled under the Participation Agreement to power that exceeds such demand for service such Participant shall offer to sell to Hydro-Québec or other parties an amount of power (and associated energy) equal to such excess.

26. Docket No. 5330-A, Order of 2/12/92, at 9–15.

the Board in other proceedings — Docket No. 5983<sup>27</sup> and Docket No. 6018<sup>28</sup> — and does not require extensive additional discussion here. As we noted in those other proceedings, for collateral estoppel to apply, the issue being estopped must have been *actually* litigated and decided in a prior proceeding. The prior inclusion of Hydro-Québec Contract costs in Citizens' rates, without any actual review of the prudence of those costs, was the result of the presumption enjoyed by a utility that its expenditures are prudent. An unchallenged presumption of prudence does not satisfy the "actually litigated and decided" requirement of collateral estoppel.

Furthermore, Citizens' position that the litigation of the prudence of its Hydro-Québec Contract costs is precluded because those costs have been reflected in prior rates would present significant practical difficulties in the administration of rate cases, for reasons that both this Board and the Vermont Supreme Court have noted.

A regulated utility's rates contain thousands of cost items. It would be an overly burdensome task for litigants and the Board to be required to make an affirmative determination about every possible relevant variable which might have an impact upon the cost of service, particularly within the seven months prescribed by 30 V.S.A. § 227(a). Therefore, to reasonably manage the ratemaking process, we rely upon the use of evidentiary presumptions to facilitate reaching a conclusion about the overall justness and reasonableness of rates without requiring an exhaustive review of hundreds or thousands of detailed cost of service items in every rate case; according to Board practice, in each rate case, a utility's filing receives the benefit of a rebuttable presumption that "expenditures claimed to support the rates were reasonable and prudent." Rate proceedings then focus on those aspects of a filing that parties choose to examine and present to the Board. Unless a party brings forth evidence challenging the reasonableness of a particular cost item, these working presumptions operate to allow the inclusion of those costs in rates, without requiring the Board to resolve the issue through an affirmative judgment on the merits.

*In re CVPS*, 769 A.2d at 688 (quoting with approval from the Board's order that was under appeal).<sup>29</sup>

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27. Docket No. 5983, Order of 2/27/98, at 18–19.

28. Docket No. 6018, Order of 4/17/98, at 24–31.

29. Although the quoted language was specifically addressing the question of whether claim preclusion applied to rate cases, the same policy considerations apply here.

*iii. Conclusion re Collateral Estoppel and Prudence*

Because the prudence of the Company's Hydro-Québec Contract purchases has not been previously litigated or decided, the second required element for collateral estoppel to apply has not been met. Consequently, collateral estoppel does not bar consideration of the prudence of Citizens' Hydro-Québec Contract purchases.

**b. Collateral Estoppel and Environmental Benefits of Hydro-Québec Contract Power**

We read the Department's response to Citizens' Motion to Strike to concede that the issue of whether the Hydro-Québec Contract has environmental benefits has previously been litigated and decided. (Specifically, the Department states, "while it is correct that the Board has found in the abstract that there are *some* environmental benefits, the question of their value is entirely open."<sup>30</sup>) Accordingly, we conclude that the Department is precluded from challenging whether the Hydro-Québec Contract has environmental benefits.<sup>31</sup> However, the Department correctly notes that the Board has never specifically quantified the appropriate valuation of those benefits, and that the Company itself has raised that valuation issue. Thus, the appropriate quantification of the environmental benefits of the Hydro-Québec Contract remains at issue in this proceeding.

Because we find the Department's testimony on the environmental benefits of the Hydro-Québec Contract to be relevant to the valuation of those benefits, we allow the testimony to remain in the record.

**c. Collateral Estoppel and Economic Usefulness**

We conclude that the issue of the economic usefulness of Citizens' Hydro-Québec Contract power purchases is not precluded by the doctrine of collateral estoppel for the simple reason that the issue has never been litigated. Citizens attempts to rely on the Board's rejection in 1994 of a Department proposal to disallow a portion of CVPS's above-market power costs, including Hydro-Québec Contract costs. For collateral estoppel to apply, as noted above, the

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30. Department Reply at 12 (emphasis in original).

31. Even if the issue were not precluded, we would continue to conclude that the Contract has environmental benefits. See Docket No. 6460, Order of 6/26/01 at 26; Docket No. 6107, Order of 1/23/01 at 43–45 and finding 45.

*same* issue must have been previously litigated and decided. While the test that the Department seeks to apply in the current proceeding to determine the economic usefulness of Citizens' Hydro-Québec Contract purchases may be similar to, or even the same as, that which it proposed in the 1994 CVPS rate case, in that case the Department was applying its test to CVPS's total power portfolio (including Hydro-Québec Contract power). Here, the Department seeks to apply its economic usefulness test to Citizens' Hydro-Québec Contract purchases.

Elsewhere in its pleadings, the Company seeks to distinguish its situation from that of CVPS or GMP on the basis that Citizens was not a Vermont Joint Owner and that its power needs differed from CVPS's and GMP's needs. We agree with Citizens that our determination of the recoverability of its Hydro-Québec Contract costs must be based on its circumstances, not those of CVPS or GMP. Consequently, whether Citizens' Hydro-Québec Contract costs are uneconomic, and if so whether any such uneconomic costs should be disallowed, are issues that were not decided in CVPS's 1994 rate case, and thus are issues that are not precluded by the doctrine of collateral estoppel.<sup>32</sup>

## **2. Laches**

Laches is the failure to assert a right for an unreasonable and unexplained period of time when the delay has been prejudicial to the adverse party, rendering it inequitable to enforce the right.

*Stamato v. Quazzo*, 139 Vt. 155, 157 (1980). While we acknowledge the Company's claim that as time passes, it can become more difficult to reconstruct its past actions and decisions, we conclude that laches does not bar consideration of the prudence issues in the current proceeding. It has been well-settled law in Vermont, from prior to the Company's entering into the Participation Agreement, that rate-case issues can be deferred to future proceedings. *In re Green Mountain Power Corporation*, 147 Vt 509, 516 (1986). Furthermore, utilities have an obligation to document their decisions that affect ratepayers, so that those decisions can later be reviewed

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32. Had we determined that the economic usefulness issue in the current proceeding was the same as had been decided in the 1994 CVPS case, we would then have needed to address whether nonetheless collateral estoppel should not be applied because (a) the claims in the two cases are substantially unrelated or (b) a new determination is warranted in light of an intervening change in the applicable law or to avoid inequitable administration of the law. *In re CVPS*, 769 A.2d at 686.

by regulatory authorities.<sup>33</sup> Under these circumstances, if Citizens failed to document the basis for its decisions and actions that resulted in its obligation to purchase Hydro-Québec Contract power — the cost of which it knew it would seek to recover from ratepayers — then Citizens acted unreasonably. As the Department correctly asserts, any prejudice to the Company is, consequently, the result of the Company's own failures. There is no inequity in allowing the Department to press its prudence arguments in the present proceeding.

Additionally, to allow Citizens to assert its laches defense would result in the same, serious practical difficulties, quoted above, that the Board and the Vermont Supreme Court have found would ensue from allowing other estoppel arguments. Thus, the Company's assertion of laches is incompatible with the practical administration of Vermont's seven-month rate proceedings. For this additional reason we reject the Company's laches claim.

### **3. Conclusion re Motion to Strike**

For the reasons set forth above, the Company's Objections to and Motion to Strike Testimony Related to Hydro-Québec are overruled and denied.

## **C. Prudence of Citizens' Hydro-Québec Contract Costs**

### **Findings**

#### **Citizens' Past Relationship with Hydro-Québec**

5. As of 1991, Citizens had been purchasing power from Hydro-Québec or its predecessor for at least 65 years. During the course of its long relationship with Hydro-Québec, Citizens was supplied with essentially firm power at low prices that kept its rates among the lowest in New England. Docket No. 5331, Order of 10/12/90 at finding 18; Hieber pf. at 3, 5.

6. Citizens had accepted five-year contracts with Hydro-Québec because they were offered at extremely attractive prices over a 65-year period. The last of these contracts was to expire in 1990. Hieber pf. at 4; tr. 4/8/02 at 101 (Hieber).

7. In the mid to late 1980's, Citizens' relationship with Hydro-Québec changed because: (1) transmission capacity was installed at Highgate, enabling the other Vermont utilities to buy

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33. Docket No. 5132, Order of 5/15/87 at 97.

power from Hydro-Québec; (2) Hydro-Québec was seeking to enter new long-term firm contracts that would have priority over delivery to Citizens and that would establish a base price for any new contract with Citizens; (3) Hydro-Québec had encountered poor water conditions that would degrade the quality of the type of power that Citizens was buying from Hydro-Québec, i.e., non-firm power, and Citizens had already begun to experience more interruptions; (4) Hydro-Québec officials told Citizens that it would no longer receive favorable treatment, and that the best deal that Hydro-Québec could offer to Citizens would be through the Hydro-Québec Contract. Hieber pf. at 6–8.

8. Due to Citizens' long-term relationship with Hydro-Québec, VED, unlike GMP and CVPS, did not have alternative baseload power supply resources such as the Vermont Yankee nuclear power station. Hieber pf. at 8.

9. The Hydro-Québec Contract provides substantial non-price benefits to Citizens, several of which were unique to Citizens. The Company's management took these additional benefits into consideration during the period leading up to the lock-in. Findings 30–37, below; Hieber reb. pf. at 4–11.

#### Citizens' Interconnection with Hydro-Québec

10. Citizens' transmission system has been physically tied to Hydro-Québec's system at the Stanstead, Québec substation for over 50 years. The bulk of Citizens' system is synchronous with Hydro-Québec's system and operates as a radial extension of the Hydro-Québec system. Hieber pf. at 9.

11. Citizens' unique interconnection with Hydro-Québec's system is asynchronous of the Vermont Electric Power Company, Inc. ("VELCO") system, and the actual energy purchased by Citizens, regardless of the source to meet its capability responsibility, has typically been supplied by Hydro-Québec. Citizens has also needed to maintain a transmission system capable of supplying safe, reliable and economic power to its customers and to the utilities which have relied on Citizens for transmission services. Thus, Citizens' transmission system has had to be independent of VELCO's system and capable of supplying Citizens' full area load from Hydro-Québec. Hieber pf. at 9; Docket No. 5331, Order of 10/12/90 at findings 19, 32.

### Citizens' Interconnection with VELCO

12. Because Hydro-Québec's system is *asynchronous* with VELCO's system, Citizens must electrically separate a block load from Citizens' system in order to interconnect it with VELCO. This process is referred to as "block loading." Docket No. 5331, Order of 10/12/90 at finding 5.

13. Block loading provides advantages to VED compared to a tie through an AC-DC-AC converter, including cost savings in excess of \$4 million per year as of 1990, even though block loading precludes networking the Hydro-Québec and VELCO systems. Docket No. 5331, Order of 10/12/90 at finding 8.

### Citizens' 120 kV Transmission Upgrade

14. In 1989, Citizens filed a petition with the Board seeking approval to upgrade to 120 kV approximately 32.5 miles of 46 kV transmission facilities from Derby Line to Richford (the "120 kV upgrade"). Docket No. 5331, Order of 10/12/90 at 3 and findings 9, 11.

15. As of 1990, Citizens' existing 46 kV transmission system between Derby Line and Richford was approximately 65 years old. Docket No. 5331, Order of 10/12/90 at finding 33.

16. To continue to operate its system at 46 kV in lieu of upgrading it to 120 kV, Citizens would have had to make a significant investment in the 46 kV transmission system at a cost in excess of the 120 kV upgrade. Docket No. 5331, Order of 10/12/90 at finding 35.

17. Additionally, the upgrade to 120 kV was expected to significantly reduce line losses at a savings of approximately \$762,000 per year at the 1992 Hydro-Québec Contract pricing. Docket No. 5331, Order of 10/12/90 at findings 34, 35.

18. The 120 kV upgrade was further expected to increase the reliability, stability and efficiency of Citizens' power system and enable other Vermont utilities to import Canadian power. Docket No. 5331, Order of 10/12/90 at finding 14.

19. Citizens signed a Block Loading Facilities Transmission Agreement with six other Vermont utilities to provide transmission capacity for approximately 25 megawatts of power and energy purchased by the Vermont Joint Owners from Hydro-Québec through the year 2015. Through that Agreement, Vermont utilities would make payments to Citizens, which would mitigate the cost to VED ratepayers of the 120 kV transmission upgrade. Docket No. 5331, Order of 10/12/90 at findings 27, 29.

20. The Board approved Citizens' proposed 120 kV upgrade. Docket No. 5331, Order of 10/12/90.

### Transmission Constraints

21. In 1991, VELCO could serve Citizens' entire load only temporarily — i.e., until there was a contingency — and assuming that back-up power was available from Hydro-Québec. Tr. 5/22/02 at 33–35 (Parker/Hinners); tr. 5/23/02 at 62–63 (Litkovitz); exh. Board-2.

22. Because VELCO's system has not been able to supply firm capacity to serve Citizens' load, it has been used as a back-up. Hieber pf. at 10; exh. Board-2.

23. In the late 1980's, Hydro-Québec told Mr. Hieber that it was reluctant to provide back-up during peak periods, and was seeking to enter long-term firm energy supply contracts. Hieber pf. at 10.

24. Had Citizens decided to purchase firm power from U.S. sources in the early 1990s, without having back-up from Hydro-Québec, the VELCO system would have required reinforcements. Hieber pf. at 10.

25. Proceeding with a Section 248 application for the transmission upgrades necessary for Citizens to transfer its load to the VELCO system, and incorporating necessary transmission upgrades, could take as long as three years. Tr. 5/23/02 at 62 (Litkovitz).

## Discussion

### **1. Positions of the Parties**

The Department contends that a portion of Citizens' Hydro-Québec Contract power costs should be deemed imprudent both because of Citizens' direct actions and because of the actions of the Vermont Joint Owners. The Department asserts that the Company imprudently failed to monitor changes in the power markets during the crucial time period before the lock-in, and imprudently failed to assess its transmission alternatives. The Department further claims that the Board should impute to Citizens the imprudence of the Vermont Joint Owners in locking-in to the Hydro-Québec Contract (which imprudence has been established in other Board proceedings).

Citizens asserts that during the spring and summer of 1991, it had already committed to a Board-approved course of action that would provide economic benefits to its ratepayers. Citizens argues further that its options were limited and that its needs differed from the other Vermont utilities. Specifically, the Company asserts that domestic alternatives to Hydro-Québec Contract power were neither physically available, due to VELCO's inability to provide firm transmission service for VED's load, nor economic in comparison due to the additional costs that would have been necessary to accommodate deliveries from domestic sources. Citizens also disputes that the Vermont Joint Owners acted as its agents, contends that to the extent the Vermont Joint Owners were its agents, the lock-in decision was beyond the scope of the agency, and asserts that, accordingly, the imprudence of the Vermont Joint Owners should not be imputed to Citizens.

## **2. The Prudence Standard**

The standard that this Board has used to determine the prudence of utility decisions and actions is long-standing and clear. Prudence is judged according to whether a utility's actions were reasonable and prudent in light of circumstances at the time, based on what the utility knew or should have known. A prudence determination is not based on hindsight or knowledge that was only available after the decision in question. A prudence determination acknowledges the managerial rights of the utility, but cannot merely presume the reasonableness of management. Instead, the utility is held responsible for taking all reasonable steps to acquire relevant information and to respond appropriately. The utility's obligations include the ongoing monitoring, review and assessment of its specific power projects, including at a minimum a continuing analysis of (a) options available should a particular project not meet expectations, (b) alternative sources, including demand-side alternatives, and (c) impacts on ratepayers and shareholders of continued investments in the project. The utility is further obligated to document its efforts in these continuing reviews and analyses, so that the utility's prudence can be judged if challenged.<sup>34</sup>

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34. Docket No. 5132, Order of 5/15/87 at 97.

In reviewing the prudence of GMP's purchases of Hydro-Québec Contract power, we explained that:

The obligation for utilities to operate in a prudent manner applies not solely to investments in specific projects, but to the full range of utility actions, including the negotiation and management of purchased power contracts. In the case of purchased power contracts, utilities have responsibilities paralleling those applicable to investments. Initially, the Company must consider the value of the contract, recognizing the full range of risks (price, availability, and environmental, among others), and the availability of alternative power sources, including demand-side management options. After entry into a contract, the utility must continue to reasonably manage its participation in the contract, exercising those rights that the contract may provide and pursuing options to increase its cost-effectiveness.<sup>35</sup>

### **3. The Prudence of Citizens in 1991**<sup>36</sup>

To determine whether the August 1991 lock-in was an imprudent action by Citizens, we begin with a consideration of the ability of the VELCO system at that time to serve Citizens' load reliably. The Department now agrees with Citizens' assertion that VELCO could not have served the full Citizens' load without reinforcements to the VELCO system.<sup>37</sup> The clear evidence in the record likewise compels us to conclude that, in the early 1990's, VELCO could not reliably serve Citizens' load without improvements to the VELCO system.

Nonetheless, the Department continues to assert that the Company was imprudent, in that the Company did not conduct any analysis of the VELCO constraints or of the costs of alleviating those constraints. We agree with the Department that Citizens appears to have failed in its obligation to fully analyze its alternatives — in particular, alternatives involving improvements to the VELCO system — in order to determine the least-cost option for serving

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35. Docket No. 5983, Order of 2/27/98 at 218.

36. As we noted in the Introduction to this Order (Section I, above), in Docket Nos. 5841/5859 this Board found Citizens' operation of VED had been imprudent, but our review in those dockets did not address the prudence of Citizens' Hydro-Québec Contract costs. Correspondingly, neither does our review and determination today of the prudence of Citizens' Hydro-Québec Contract costs affect our determination in those prior dockets of the Company's imprudence in other areas.

37. Department Brief at 10.

the Company's Vermont customers.<sup>38</sup> Nonetheless, this failure by itself does not justify a finding that Citizens' Hydro-Québec Contract power costs have been imprudently incurred; in fact, in light of the evidence presented and the circumstances faced by Citizens, we conclude that the 1991 lock-in was prudent *for Citizens*, despite not being so for other Vermont utilities. We reach this conclusion for the following reasons.

First, this Board (with the support of the Department) in 1990 approved the Company's proposed 120 kV transmission upgrade pursuant to 30 V.S.A. § 248. While there was no explicit finding that the project represented the least-cost alternative for the Company,<sup>39</sup> the Board's decision nonetheless clearly found the project to provide substantial savings, *and* that without the 120 kV upgrade, the existing 46 kV line would need upgrading at an even greater cost and without the additional benefits (loss savings and cost contributions by other utilities) of the 120 kV project. Given these factors, it clearly was reasonable for Citizens to proceed with the 120 kV upgrade.<sup>40</sup>

Having started on the Board-approved (and Department-supported) path of constructing the 120 kV upgrade and purchasing the Hydro-Québec Contract power, Citizens could not immediately change course. Assuming that power markets were changing as rapidly in 1991 as the Department contends, the Company's capital-intensive and regulatory-intensive plans could not readily change track. Especially in light of the Company's pressing need for firm baseload capacity, and its physical inability to quickly turn to domestic sources to meet that need, we

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38. See Finding 39, below. Also, in Docket Nos. 5841/5859 we extensively addressed the Company's longstanding failure to conduct appropriate and necessary least-cost analyses of its available alternatives for providing service to its Vermont customers, and we penalized the Company accordingly both for this general management failure, and for the specific violation of a Board order requiring such least-cost analyses. Docket Nos. 5841/5859, Order of 6/16/97 at 170–188, 292–293, 300–306.

39. Current section 248(b)(6), which requires that a project be consistent with the resource selection principles articulated in the utility's least-cost integrated resource plan, was only added to the statute in 1992.

40. The Department contends that the configuration of the 120 kV line might have been changed, to connect to VELCO rather than Hydro-Québec, had a proper least-cost analysis been conducted and shown such a VELCO connection to be part of the overall least-cost alternative. However, the Department has not asserted that the Company withheld pertinent information in Docket No. 5331, and, as discussed below, we reject the Department's suggestion that we find the Company imprudent for its analytical failures in the late 1980's. Consequently, having received Board approval for its proposed 120 kV upgrade and in light of the clear benefits of the upgrade, we conclude that it was reasonable for Citizens to proceed with the upgrade, especially in light of its pressing need for firm baseload power and the delays (for planning, design, and regulatory approval) that would inevitably accompany a substantial modification to its 120 kV transmission project.

cannot, on the record before us, conclude that it was imprudent for the Company to commit to the Hydro-Québec Contract power purchases in 1991.<sup>41</sup>

Second, Hydro-Québec had clearly indicated that it was not interested in providing back-up power to Citizens. Although the Department has suggested that Hydro-Québec would nonetheless provide back-up service, there is no evidence in the record to support this assertion.

In its Reply Brief, the Department relies on the Securities and Exchange Commission ("SEC") Form 10-K for 1993 filed by Consolidated Edison Company of New York ("ConEd") to challenge the Company's claim that Hydro-Québec made no sales to New York after New York canceled a contract with Hydro-Québec in 1992.<sup>42</sup> We find that the ConEd Form 10-K is of no particular help in our resolution of the issues in the current proceeding. We have not adopted the Company's specific proposed finding that the Department challenges (proposed finding number 38 in Citizens' Brief), because we have concluded that regardless of whether the ConEd Form 10-K is considered, the record is insufficient for us to draw the specific conclusion that Citizens presents in its proposed finding.

More significantly, the ConEd Form 10-K states that ConEd has an agreement with the New York Power Authority ("NYPA") to purchase 780 MW of firm capacity and associated energy from Hydro-Québec, through a contract between NYPA and Hydro-Québec, until October of 1998. Because the sales to ConEd are pursuant to a contract for firm capacity through 1998, their existence does not refute Citizens' assertion that Hydro-Québec would not have provided back-up service (or secondary products) in the absence of a firm contract.

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41. We recognize that the Company contends that as a non-Vermont-Joint-Owner Participant, it had no say in the 1991 lock-in, and instead was committed to its purchases earlier, when it executed the Participation Agreement. We do not find this argument to be persuasive, for two reasons. First, even if the Company had no legal ability to affect the lock-in decision, it remained obligated to take whatever steps were available to it, including attempts to influence the lock-in decision by reasoned analysis and argument. Second, as we discuss below, the Company could not escape its responsibility for prudent decisions by contracting away the ability to make the decisions.

42. In its Reply Brief, the Department asks that we take administrative notice of ConEd's 1993 SEC Form 10-K. In a letter filed on June 28, 2002, Citizens objects to this request on the grounds that it is untimely. Citizens also asserts that to include the ConEd Form 10-K in the record would be prejudicial to the Company, due to a lack of meaningful opportunity to respond.

We grant the Department's request for administrative notice. Although the Company objects to the request as untimely, it does not contest that the substance of the document is appropriate for administrative notice. We also conclude that there is no prejudice to the Company because, as we discuss in the body of the text, we are unable to draw any meaningful conclusions from the information presented in the ConEd Form 10-K.

Furthermore, the ConEd Form 10-K does not indicate when the contract with Hydro-Québec started, so it may have predated any cancellation of the New York contract to which Citizens is referring. Finally, the Department itself notes that the Form 10-K refers to cancellation of a "new" (follow-on) agreement in 1994, so it is not clear to what extent if any the document is relevant to a consideration of Hydro-Québec's willingness to continue sales subsequent to a contract cancellation.

For these reasons, we can draw no meaningful conclusions from the indicated sales by Hydro-Québec to ConEd, in the absence of additional information.

Based on the evidence of record, we conclude that Citizens could not reasonably rely on the availability of back-up service from Hydro-Québec. For Citizens to have proceeded on the hope that such back-up power would be available, despite Hydro-Québec's indications to the contrary, would have amounted to gambling with the reliability of service to its customers. We cannot fault Citizens for not taking this risk.

Third, as Citizens has accurately noted, in the spring and summer of 1991 it was facing a pressing need for firm baseload capacity. Its existing contract with Hydro-Québec for firm baseload power had already ended, and Hydro-Québec had plainly stated that the best deal it would provide to the Company would be through the Hydro-Québec Contract. The Department's witness acknowledged that this need for baseload capacity resulted in the Hydro-Québec Contract power being of greater value to Citizens than to the other Vermont purchasers.<sup>43</sup>

Next, and significantly, the Hydro-Québec Contract power provided substantial benefits, several of which were unique to Citizens. Even though the market cost of power was falling such that the economics of the Contract as a whole became questionable and it was imprudent for CVPS and GMP to lock-in the Contract, the additional benefits to Citizens would need to be taken into account to determine whether the Contract was no longer beneficial to the Company. And, the Company's management in fact did take these additional benefits into account during the period leading up to the lock-in.

Thus, in the spring and summer of 1991, Citizens' circumstances differed substantially from those of GMP and CVPS. While we have previously determined that the lock-in was

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43. Tr. 4/10/02 at 76–77 (Chernick).

imprudent for CVPS and GMP,<sup>44</sup> that same lock-in decision was not imprudent for Citizens given its unique circumstances.

For this same reason — i.e., because the lock-in was reasonable for Citizens in light of its circumstances — we reject the Department's contention that the imprudence of GMP and CVPS in the lock-in decision must be imputed to Citizens. The Department correctly notes that this Board's precedents are unequivocal and clear: a utility must be, and will be, held accountable for the decisions made by its agents and designees. In reviewing the prudence of CVPS's investment in the Seabrook I nuclear power station, the Board stated:

We cannot accept the proposition that public utilities can terminate their responsibilities to their ratepayers merely by assigning those responsibilities to a third party against which no recourse is feasible.<sup>45</sup>

We expressly reaffirm this fundamental proposition. A utility cannot escape responsibility for its management decisions by delegating or contracting away those decisions. It is the utility and its owners, not its ratepayers, who control those decisions, either by making the decisions directly or by assigning them to third parties.

Consistent with this bedrock principle, we do impute to Citizens the Vermont Joint Owners' decision to lock-in the Hydro-Québec Contract; however, we do not treat it as imprudent because, quite simply, the lock-in was not an imprudent decision *for Citizens*. As the evidence has shown and as we have explained above, during the spring and summer of 1991, a decision by Citizens to move forward with its Hydro-Québec Contract purchases was reasonable in light of the circumstances specific to Citizens. The Department's argument that we should automatically impute the imprudence of Citizens' agents to Citizens fails because, while the decision may have been an imprudent one for the agents themselves, it was not so for Citizens, the principal.

#### **4. Prudence of Citizens in the late 1980's**

The Department contends that Citizens acted imprudently in the late 1980's, after Hydro-Québec had notified the Company of Hydro-Québec's change in policy. According to the

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44. *In re CVPS*, 769 A.2d at 678; Docket No. 5983, Order of 2/27/98 at 231–241.

45. Docket No. 5132, Order of 5/15/87 at 94–95.

Department, at that time Citizens should have fully analyzed its alternatives to Hydro-Québec, including the costs of any transmission upgrades necessary to take power from domestic sources.

In reply, Citizens contends that (1) the Department's own witness repeatedly stated that the relevant time period for judging the prudence of Citizens was the spring and summer of 1991, (2) the only evidence to support the Department's claim was presented in the Department's rebuttal case, and (3) the Board approved Citizens' 120 kV upgrade in Docket No. 5331, which included a determination that the Company's Hydro-Québec Contract entitlements were its lowest-cost alternative for firm baseload power.

The Board's Order in Docket No. 5331 expressly found that

Citizens' [Hydro-Québec Participation Agreement] entitlements are the lowest cost firm, baseload power supply resource available to meet Citizens' immediate and future need for such power.<sup>46</sup>

The Board reached this finding after consideration of the contemporaneous evidence submitted by all parties to that proceeding (including the Department). In the absence of any showing that in Docket No. 5331 Citizens withheld relevant information or misrepresented its circumstances,<sup>47</sup> there is insufficient basis to revisit our earlier finding. Accordingly, we reject the Department's recommendation that we now find the Company's Hydro-Québec Contract purchases to be imprudent on the basis that the Company failed to analyze fully its options in the late 1980's.

### **5. Prudence of Citizens as Successor to Franklin**

Franklin Electric Light Company ("Franklin") was one of the Vermont Joint Owners. In 1993, Franklin merged into Citizens.<sup>48</sup> The Department contends that, as a consequence of the

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46. Docket No. 5331, Order of 10/12/90 at 16.

47. The Department does contend that the Company's present statements that VELCO could not have reliably served the full Citizens load in the late 1980's and early 1990's is inconsistent with the Company's representations in Docket No. 5331. We have reviewed the Docket No. 5331 Order, and conclude that the findings in that Order are consistent with the Company's current position. Department witness Chernick cites excerpts from the Company's proposal for decision in Docket No. 5331 to support the Department's claim that, in that earlier Docket, Citizens had represented that its load could be served by VELCO. Again, we see no inconsistency between those excerpts and the Company's current representations that, in the late 1980's and early 1990's, VELCO could provide back-up service for Citizens' load, but not reliable firm service.

48. See Docket No. 5637, Order of 7/23/93, in which the Board approved the merger.

merger, Citizens is now a Vermont Joint Owner.<sup>49</sup> However, in its briefs the Department fails to explain what import, if any, this has in determining whether Citizens' Hydro-Québec Contract power is imprudent. Furthermore, as we have already discussed, because the lock-in was not imprudent for Citizens in light of its unique circumstances, whether or not the Company is now a Vermont Joint Owner would not change those historical facts, and thus would not change our conclusion that the lock-in was not imprudent for Citizens.<sup>50</sup>

#### **D. Economic Usefulness of Citizens' Hydro-Québec Contract Costs**

##### **Findings**

26. In its initial rate filing of October 31, 2001, the Company included \$13,057,000 of Hydro-Québec Contract costs, reflecting 206,050 MWh of Contract power purchases from January 1, 2001, through December 31, 2001. Hieber pf. at 34; exh. CCC-RBH-2; Foley pf. at 2.

27. Two sets of adjustments to these figures are necessary to reflect the Company's costs of Hydro-Québec Contract power during the rate year. First, the energy purchases under the Hydro-Québec Contract should be modified to reflect a Company-proposed schedule of delivered energy to match the test-year loads. This adjustment reduces the delivered energy by 426 MWh, while increasing the total cost by \$90,570. The second adjustment is required to account for a change to a 65 percent capacity factor (from the current 75 percent) for the power year beginning November, 2002. This second adjustment further reduces the energy deliveries by 17,906 MWh, and reduces the cost by \$480,397. As a result of these two sets of adjustments, the Company's expected cost of Hydro-Québec Contract power in the rate year is \$12,667,173, for purchases of 187,718 MWh of Contract power. Thus, the price of the Company's Hydro-Québec Contract purchases in the rate year will be approximately 6.75¢ per kWh ( $\$12,667,173 \div 187,718$  MWh). Foley pf. at 3, 7; Foley reb. pf. at 4.

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49. Department Brief at 11.

50. At most, it is conceivable that the lock-in was imprudent for Franklin, but that issue has not been raised, and as a result, we have not been presented with the facts necessary to determine the prudence of Franklin and to determine the damages of any imprudence by Franklin. We would anticipate, however, that even if any of Franklin's Hydro-Québec Contract costs were imprudently incurred, those imprudent costs would have a minimal effect on Citizens' rates, given the great difference in the relative sizes of VED's system and the former Franklin system.

28. During the rate year, the market cost of power to replace Citizens' Hydro-Québec Contract power would be approximately 4.5¢ per kWh. Hieber pf. at 34-35; Chernick pf. at 39; Steinhurst pf. at 2; exh. CCC-RBH-5.

29. The price of Citizens' purchases under the Hydro-Québec Contract is expected to be above-market by approximately \$27.8 million over the remaining life of the Contract. Biewald pf. at 11; tr. 5/21/02 at 73-74 (Biewald); exh. DPS-BEB-1.

#### Benefits to VED of the Hydro-Québec Contract

30. The Hydro-Québec Contract provides an environmental benefit compared to alternative supply resources. Hieber reb. pf. at 8-9.

31. The Company presented two estimates of the value of the Hydro-Québec Contract's environmental benefits, one of 0.25¢ per kWh and one ten times as large, 2.5¢ per kWh.<sup>51</sup> The smaller figure is based on the approximately \$200 million in benefits, including societal costs, that the Board associated with the Hydro-Québec Contract in Docket No. 5330. The higher value is based on the environmental externality adders that the Department included in its 1997 Statewide Energy Efficiency Plan, *The Power to Save*. Those adders are derived from ones adopted by the Massachusetts Department of Public Utilities ("DPU"). Hieber reb. pf. at 8-9; Higgins reb. pf. at 12, 26; Biewald reb. pf. at 12; exh. CCC-Higgins-7; see Docket No. 5330, Order of 10/12/90 at 26.

32. The Massachusetts externality adders only addressed air emissions, with the Massachusetts DPU explicitly noting that the adders did not address non-air externalities. Because the Massachusetts adders do not include values for the environmental impacts of large hydroelectric generation (such as that of Hydro-Québec), it is inappropriate to rely solely on the Massachusetts adders in an assessment of the environmental benefits of the Hydro-Québec Contract. Biewald reb. pf. at 12-14; tr. 5/21/02 at 119-121 (Biewald).

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51. The Company's witness supported an environmental externality value of 2.8¢ per kWh for the overall market, and (using the same methodology) an externality adder of 0.3¢ per kWh for the Hydro-Québec Contract. Higgins reb. pf. at 26. The asserted environmental benefit of the Hydro-Québec Contract is represented by the difference between these figures, or 2.5¢ per kWh.

33. Beyond its environmental benefits, the Hydro-Québec Contract provides additional benefits that are unique to Citizens. Hieber reb. pf. at 4–11.

34. The first of these unique benefits to Citizens — the avoidance of the cost of higher transmission line losses that Citizens would have incurred had it received its power from domestic sources — is estimated to be 0.15¢ per kWh. Hieber reb. pf. at 8.

35. The second unique benefit to Citizens from the Hydro-Québec Contract is the availability of low-price secondary products from Hydro-Québec, including assured secondary energy, special contract energy for large interruptible customers, and tertiary/dump energy. As a result of participating in the purchase of power under the Hydro-Québec Contract, Citizens has been able to purchase additional secondary products that have the effect of lowering the average cost of the Hydro-Québec Contract. It is unlikely that Hydro-Québec would have offered these beneficial secondary products to Citizens if Citizens were not also buying firm energy from Hydro-Québec. For 2001, this benefit was worth approximately 0.45¢ per kWh. Hieber reb. pf. at 4, 6, 10; tr. 5/21/02 at 140–143 (Hieber).

36. The third benefit unique to Citizens is the Company's receipt of wheeling revenues pursuant to the Block Loading Transmission Facilities Agreement. Citizens was able to enter into this Agreement as a result of the Hydro-Québec Contract. This Agreement has provided additional wheeling revenues to Citizens, and helped mitigate the rate impacts of the 120 kV upgrade to its transmission line that the Board approved in Docket No. 5331. Initially, the additional revenues amounted to approximately \$1 million per year. They are now approximately \$700,000 per year due to a lower wheeling rate. This equates to additional revenue of approximately 0.4¢ per kWh. Docket No. 5331, Order of 10/12/90 at findings 28, 29; Hieber reb. pf. at 4, 6, 10.

37. The fourth benefit unique to Citizens associated with its purchases of Hydro-Québec Contract power is avoided VELCO transmission charges that would result from losing the internal generation credit given to Hydro-Québec block loaded deliveries. This benefit is estimated to be 0.2¢ per kWh. Hieber reb. pf. at 5, 8, 11.

38. By relying on its connection with Hydro-Québec, Citizens avoided the cost of upgrading its transmission facilities and sub-facilities to provide a connection to VELCO at Irasburg. Citizens further avoided VELCO charges that would have resulted from VELCO

having to make additional investments to serve Citizens' load on a long-term firm basis. Hieber reb. pf. at 5, 6–7, 10–11.

39. During the late 1980's to early 1990's, Citizens never performed any analyses of the costs of removing the transmission constraints that prevented the Company from receiving reliable firm transmission service from VELCO for all of Citizens' load. VELCO also did not perform such an analysis, and is unable to estimate the costs of the system improvements that would have been necessary for VELCO to have provided firm service for all of Citizens' load. Chernick pf. at 21; Litkovitz reb. pf at 5; tr. 4/8/02 at 88–89, 103 (Hieber); tr. 5/23/02 at 62, 63 (Litkovitz); exh. Board-2.

40. If VELCO was serving all of Citizens' load, as a matter of maintenance and reliability, a number of circuit breakers would be required at a cost of approximately \$200,000 per unit. VELCO is already planning on installing nine circuit breakers as part of its Northern Loop project; it is not clear whether a different number would be required for a system configuration designed to serve Citizens' load. VELCO would also need to install some reactive compensation measures, but their costs cannot be estimated because they have not been studied. Tr. 5/22/02 at 33, 42–43 (Parker/Hinners).

41. If VELCO were to serve Citizens' load today, it would have to advance certain transmission upgrades to reinforce service to the Burlington area, estimated to be in the order of \$100 to \$150 million, by approximately 18 months. Tr. 5/22/02 at 37–38 (Parker/Hinners); Hieber reb. pf. at 7.

42. This advanced investment by VELCO would not have any material impact on VED's costs, for the following reasons. The estimated VELCO costs include routine replacements and projects that would not affect VED. Also, much of the VELCO work would be treated as pooled transmission facilities by the New England Power Pool, such that only five percent of the carrying costs would be assigned to Vermont, with VED in turn bearing only a small portion of that five-percent assignment. Litkovitz reb. pf. at 9.

### Discussion

We are presented with three fundamental disagreements between the parties with respect to the Department's proposed disallowance of a portion of the Company's Hydro-Québec

Contract costs as not economically useful: (1) whether collateral estoppel precludes consideration of the Department's economic usefulness test; (2) whether as a matter of sound regulatory policy the Board should employ an economic usefulness test; and (3) whether Citizens' Hydro-Québec Contract purchases are in fact economically useful due to certain non-price benefits.

We have already resolved the first of these disputes, in our disposition of the Company's Motion to Strike. (See Section IV.B, above.) Now we address the remaining two disputes in turn.

### **1. Economic Usefulness as a Regulatory Policy**

Long-standing regulatory policy in Vermont, and throughout the United States, has held that a utility may fully recover in rates the costs of a resource only if it is both used — i.e., necessary for the utility's provision of service to its ratepayers — and useful — i.e., economic for the purposes that it is serving. A resource is not used and useful when it is not expected to yield net present value benefits, after consideration of non-price benefits, over its lifetime.<sup>52</sup> (We refer to this concept as "economic usefulness" in today's Order.) This Board applies the economic usefulness test to purchased power contracts, and not just to investments in generation plants.<sup>53</sup>

Citizens contends that application of an economic usefulness test is poor regulatory policy, in that it results in cost disallowances at any time based on unreliable forecasts. The Company argues that the test is inequitable by disallowing costs of decisions that turn out to be uneconomic, while not allowing increased profits for economically beneficial decisions. The Company further criticizes the economic usefulness test as incompatible with a utility's least-cost planning obligations, with the utility forced to obligate itself to long-term commitments that may result in future cost disallowances due to the unreliability of forecasts.

The Department asserts that the economic usefulness test does indeed provide for equitable treatment, both in that regulated utilities enjoy a number of advantages compared to

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52. Docket No. 6545, Order of 6/13/02 at 91; Docket No. 5983, Order of 2/27/98 at 242–245. *See also* Docket No. 5132, Order of 5/15/87 at 129–132, 163.

53. Docket No. 6545, Order of 6/13/02 at 92; Docket No. 5983, Order of 2/27/98 at 243–245.

firms in competitive markets, and in that unlike competitive enterprises, a utility's uneconomic costs are shared by ratepayers. The Department contends that the economic usefulness test is in fact compatible with least-cost planning, because only significant resources have been subject to an economic usefulness review, because the Board has recognized that prudent resource portfolios can include above-market resources, and because failure to apply the test to power contracts would be antithetical to least-cost planning by skewing utility decision-making away from direct investments.

We have considered Citizens' arguments against application of the economic usefulness doctrine to purchased power contracts, and find that they do not present any basis for departing from our prior practice. Instead, we conclude that the economic usefulness test, including its application to power contracts, represents equitable and sound regulatory policy. The test furthers the purpose of regulation as a substitute for competitive markets, by assigning some (but not all) of the risk of uneconomic decisions to companies. The test produces equitable results; although regulation may limit the upside for investors should a utility's decision prove to be especially beneficial, the economic usefulness test symmetrically limits their downside risk by sharing the financial consequences of uneconomic decisions.

A similar limitation on a regulated utility's exposure to market risk was noted by Judge Starr in *Jersey Central Power & Light Company v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987). In his concurring opinion, Judge Starr discussed at length the rationales and constitutionality of the prudence and used-and-useful tests. In his discussion, he observed that, like airlines, utilities are not exempt from market forces that may render a particular investment unsuccessful:

The comparison is, of course, imperfect since the airline will enjoy the full fruits of financial success if its acquisition program succeeds. A utility's rate of return, in contrast, is limited by regulation. *On the other hand, the airline is not provided with the protection of a regulatory body's interest in preserving the financial soundness of the enterprise.*

810 F.2d at 1191 n.2 (Starr, J., concurring) (emphasis added). This Board has, indeed, recently allowed a regulated utility to recover above-market and imprudently incurred costs, in order to preserve the company's financial integrity.<sup>54</sup>

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54. Docket No. 5983, Order of 1/23/01.

And, as we concluded in Docket No. 5983:

failure to apply the used-and-useful principle to both investments and power purchases would create perverse incentives to fill resource needs with purchased power contracts simply because rate-making practices made doing so less risky, notwithstanding the merits of the particular power sources and the obligation to meet demand at the least societal cost.<sup>55</sup>

Citizens also contends that the economic usefulness test should not apply to costs that the Board determines to have been prudently incurred. Citing the Department's statement that the only utility resources that have been subjected to an economic usefulness review are those that have also been deemed imprudent,<sup>56</sup> Citizens asserts that, "according to the Department, should the Board determine that Citizens' Hydro-Québec costs were not imprudently incurred, . . . there is no basis on which to apply Mr. Biewald's economic used and useful test."<sup>57</sup>

We reject the suggestion that an economic usefulness review is somehow dependent on a finding of imprudence. The Department is incorrect in stating that this Board has only applied the economic usefulness test to a resource that had also been found imprudent. In Docket No. 5132, we reviewed our precedent on the ratemaking treatment of uneconomic investments by utilities, and concluded:

We have reviewed our treatment of five major uneconomic investments, involving both nuclear and non-nuclear projects. In four of those five cases we concluded that the burden should be shared between investors and ratepayers; in some cases we did that after explicitly noting that no imprudence had been shown. In the fifth case we rejected an argument of imprudence, but expressly noted that an argument of sharing had not been raised and could not be ruled upon at that time.<sup>58</sup>

In that same proceeding, the Board determined that Central Vermont Public Service Corporation's prudent but uneconomic investment in Unit I of the Seabrook Nuclear Power

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55. Docket No. 5983, Order of 2/27/98 at 243 (footnote omitted).

56. Department Brief at 46

57. Citizens Reply Brief at 15.

58. Docket No. 5132, Order of 5/15/87 at 144. For example, in one of those prior dockets the Board considered a request by CVPS for recovery of its costs for the Montague Nuclear Power Plant. In its decision, the Board expressly stated, "We assume, for purposes of this case, that the costs were prudently incurred." The Board then required shareholders and ratepayers to share the costs of the uneconomic investment. Docket Nos. 4496/4504, Order of 12/4/81 at 11–14.

Station must be shared between shareholders and ratepayers.<sup>59</sup> Consistent with our precedent, we have explicitly noted that prudence and economic usefulness are independent requirements for full cost recovery.<sup>60</sup> Furthermore, the basis in sound regulatory policy for the economic usefulness requirement (discussed above) in no way depends on the imprudence of the utility in acquiring or managing the resource in question.

The courts have similarly recognized that prudence and used-and-usefulness are two distinct tests, separately applied to determine the recoverability of a utility's costs. In his concurring opinion in *Jersey Central*, Judge Starr observed:

Requiring an investment to be prudent when made is one safeguard imposed by regulatory authorities upon the regulated business for benefit of ratepayers. As I see it, the "used and useful" rule is but another such safeguard. The prudence rule looks to the time of investment, *whereas the "used and useful" rule looks toward a later time.* The two principles are designed to assure that the ratepayers, whose property might otherwise of course be "taken" by regulatory authorities, will not necessarily be saddled with the results of management's defalcations or mistakes, or as a matter of simple justice, be required to pay for that which provides the ratepayers with no discernible benefit.

The two principles thus provide assurances that ill-guided management or management that simply proves in hindsight to have been wrong will not automatically be bailed out from conditions which government did not force upon it.

810 F.2d at 1190 (Starr, J., concurring) (emphasis added, footnote omitted).

Having concluded that the economic usefulness test represents an appropriate regulatory policy which applies regardless of the prudence of the underlying resource-acquisition and resource-management decisions, we now turn to its application to the specific facts of this case.

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59. Docket No. 5132, Order of 5/15/87 at 134, 165–166.

60. Docket Nos. 5630/5631/5632, Order of 12/30/93 at 50–52; Docket No. 5854, Order of 12/30/96 at 67–70.

## **2. Economic Usefulness of Citizens' Hydro-Québec Contract Power**

In order to evaluate the economic usefulness of Citizens' Hydro-Québec Contract power, it is necessary to compare its cost with the cost of alternatives available to Citizens today. The best proxy for these alternatives is the New England wholesale power market.<sup>61</sup>

The price of Citizens' Hydro-Québec Contract purchases exceeds market prices in the rate year.<sup>62</sup> A simple comparison of the contract price of Citizens' Hydro-Québec Contract power to market prices would thus indicate the Hydro-Québec Contract power to be uneconomic, and thus to fail the economic usefulness test. However, the Company contends that the analysis of the economic usefulness of its Hydro-Québec Contract purchases should not end there. Instead, Citizens proposes a number of adjustments that, if fully accepted, would bridge the gap between its Hydro-Québec Contract costs and the market price of power. We will separately consider each of the Company's proposed adjustments.<sup>63</sup>

### *i. Environmental Benefits*

In our consideration of the Company's Motion to Strike in Section IV.B, above, we noted that this Board has previously, and repeatedly, found that the Hydro-Québec Contract has

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61. Analyzing the economic usefulness of the Contract in the upcoming rate year is different from analysis of prudence based on Citizens' options in 1991. In 1991, Citizens would not have been readily able to replace the power purchased under the Hydro-Québec Contract with power from the United States because of transmission constraints (specifically, that VELCO could not reliably serve Citizens' load without improvements to the VELCO system) which still exist today. However, since 1991 there have been significant changes in the structure of New England's wholesale market, including (1) the Federal Energy Regulatory Commission's ("FERC") requirement that utilities that own or control interstate transmission lines have "open access" transmission tariffs that enable entities other than the owner to use those transmission lines on terms and conditions similar to those the owner provides itself, and (2) new market rules regarding the operation of the wholesale market in New England. *See, e.g.* FERC Order No. 888, 75 FERC ¶ 61,080 (1996), and *In Re New England Power Pool*, 87 FERC ¶ 61,045 (1999). These changes mean that Citizens today could purchase power from the New England wholesale market pool (as an alternative to a bilateral contract like the one with Hydro-Québec). As a result, the price of power in the New England wholesale market is the appropriate starting point for an evaluation of the economic usefulness of Citizens' Hydro-Québec Contract power. Citizens itself has used forward market data for the New England pool market price, and has not demonstrated any quantifiable basis for offsetting additional transport costs against such market rates. *See*, Section IV.D.2.vi, below.

62. Findings 27 and 28, above.

63. In its testimony, the Company included among its proposed adjustments an adjustment for inefficient operation of high-cost generation to provide area protection. Hieber reb. pf. at 5, 8, 11. The Department opposed this adjustment. Chernick reb. pf. at 18. Citizens has not briefed this particular proposed adjustment, so we do not consider it.

environmental benefits when compared to available supply-side alternatives. We also noted that the Department, in its response to the Motion to Strike, did not challenge the preclusive effect of our earlier determinations, but instead argued (correctly) that the quantification of the environmental benefits has yet to be settled.

In its testimony and briefing on this issue, the Department has nonetheless not offered any proposed estimation of the value of the Contract's environmental benefits, choosing instead to attack the Company's proposed valuations as "unsubstantiated and conceptually flawed."<sup>64</sup> Difficult though it may be to assign a dollar value to environmental benefits such as avoided air emissions, it would be an even greater conceptual flaw to ignore those benefits (whose existence, again, has previously been determined). The only estimates of those benefits in the record of this proceeding are those proffered by the Company, with values of 0.25¢ per kWh and 2.5¢ per kWh. In order to account for the environmental benefits in our analysis of the Contract's economic usefulness, and in light of the Company's inappropriate sole reliance on the Massachusetts DPU adders in deriving the larger value, we will use the Company's low value as a proxy for the avoided environmental externalities. However, we expressly state that we are not here making any determination that this rough value that we use in our analysis represents the correct, or best, valuation of the Contract's environmental benefits. Instead, our intent is merely to recognize those benefits by assigning them a value greater than zero, and the only such values in the record are those presented by Citizens.

*ii. Line Loss Savings*

The Department agrees that the Company's proposed adjustment for transmission line loss savings is appropriate.<sup>65</sup> We find this adjustment to be reasonable, and thus accept the Company's 0.15¢ per kWh adjustment for line loss savings.

*iii. Additional Wheeling Revenues*

The Department disagrees with the Company's claim that additional wheeling revenues represent a benefit of Citizens' Hydro-Québec Contract purchases, asserting that they are "simply

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64. Department Brief at 14.

65. Chernick reb. pf. at 18.

transfers from other Vermont utilities."<sup>66</sup> Regardless of the source of the wheeling revenues, they are of benefit to Citizens and its ratepayers. While we would be reluctant to characterize as a benefit any costs that one utility imposed on another unwilling (or unwitting) utility,<sup>67</sup> that is not the case here. The other Vermont utilities paying these wheeling charges to Citizens are doing so knowingly and willingly. Moreover, in approving the Company's 120 kV transmission upgrade in Docket No. 5331, the Board expressly acknowledged that the other Vermont utilities would be making these payments to Citizens.<sup>68</sup>

Consequently, it is appropriate to recognize these wheeling revenues that Citizens is in fact receiving. Although the Department disputes the Company's proposed quantification of this benefit and the other claimed benefits on the basis that the Company did not perform a detailed analysis of the precise values, the Department has not offered any alternative estimates. Despite the lack of a rigorous analysis, the Company's expert witness, Mr. Hieber, testified that he was "comfortable" with the estimates he presented.<sup>69</sup> We accept the testimony of Mr. Hieber as sufficiently reliable for our present purpose. We therefore accept the only value in the record, which is 0.4¢ per kWh.

*iv. Loss of VELCO Internal Generation Credit*

The Department contends that no benefit should be attributed to Citizens' avoidance of losses associated with VELCO internal generation credits, on the basis that the savings "are simply transfers from other Vermont utilities, since the only change is in the allocation of VELCO's embedded costs."<sup>70</sup> We disagree. Just as with the wheeling revenues, these avoided charges represent real savings to the Company and its ratepayers that should be recognized. We thus accept the Company's proposed adjustment as appropriate, and we adopt its proposed quantification (which, again, is the only value in the record) of 0.2¢ per kWh.

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66. Chernick reb. pf. at 17.

67. The same is true for costs, such as environmental externalities, that a utility may impose on non-utility entities or the population at large.

68. Docket No. 5331, Order of 10/12/90 at finding 29.

69. Hieber reb. pf. at 5.

70. Chernick reb. pf. at 18.

*v. Secondary Products from Hydro-Québec*

The Department claims that the Company has not demonstrated that its secondary purchases from Hydro-Québec are linked to the Hydro-Québec Contract, and that instead such purchases could have been made had the Vermont utilities canceled the Contract. To support its position, the Department points to findings from Docket No. 5331 which it contends "show that if economy energy was available from Hydro-Québec, Citizens could switch a block of load to the Hydro-Québec system to take advantage of it."<sup>71</sup>

We have reviewed the findings from Docket No. 5331 that the Department cites. Those findings are consistent with the Department's contention that Citizens could physically switch load to the Hydro-Québec system if Hydro-Québec made economy energy available. However, those findings from Docket No. 5331 are insufficient to support the ultimate conclusion that the Department would have us draw — i.e., that Citizens would be able to purchase secondary products from Hydro-Québec in the absence of the Hydro-Québec Contract. The evidence before us indicates that it is unlikely that Hydro-Québec would have offered the secondary products to Citizens without the Hydro-Québec Contract. Mr. Hieber testified as follows:

MR. JANSON: I think I'm understanding you to say it's the block loading nature of your interconnection with Hydro-Québec rather than any specific feature of the Hydro-Québec Vermont Joint Owner contract which has made these other energy products available through Citizens; is that correct?

MR. HIEBER: No. I think I would take some exception to that. My negotiations with Hydro-Québec clearly made this point to me loud and clear. We are not interested in providing all these other ancillary backup services and giving you a free ride once in awhile because you are a nice guy. We are interested in selling firm energy priced contracts because they are higher priced contracts. They brought the maximum value that you could get. These other contracts were just contracts that were made available as a function of buying the firm energy.<sup>72</sup>

There is no evidence in the record that refutes this testimony.

Accordingly, we accept the Company's proposed adjustment to reflect secondary purchases. We also accept the Company's estimated value of this adjustment of 0.45¢ per kWh.

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71. Department Reply Brief at 7.

72. Tr. 5/21/02 at 141–142 (Hieber).

*vi. Avoided Transmission Costs*

The Company contends that in order to take firm service from domestic sources, significant upgrades would have been necessary both to its and to VELCO's transmission facilities, resulting in increased costs to the Company (both direct costs in upgrading the Company's own facilities, and in the form of increased charges from VELCO to reflect the VELCO upgrades). The Department asserts that any such increased costs are unknown and uncertain due to the Company's failure to perform the necessary analyses at the time it was deciding whether to commit to the purchase of Hydro-Québec Contract power and to construct the 120 kV upgrade. Consequently, the Department argues that these alleged costs should be disregarded.

The record does not reveal with sufficient clarity what upgrades to the Citizens and VELCO systems would have been, or would now be, required for the Company to obtain reliable firm service from VELCO. It appears that some upgrades would be necessary, but we cannot on the record before us determine the cost of those upgrades, nor the cost *to Citizens* of those upgrades. Accordingly, we are also unable to determine how those costs compare to the costs incurred by the Company to accommodate its deliveries of Hydro-Québec Contract power.<sup>73</sup> While some of the witnesses have speculated that the costs of transmission upgrades necessary to rely on domestic sources might, or might not, be greater than the costs of the upgrades actually undertaken, their testimony is just that: speculation.

The fundamental reason that we do not know the comparative costs is Citizens' failure to analyze these costs. The Company never performed an analysis of the costs of removing the transmission constraints that it contends precluded it from relying on domestic sources for firm baseload power. (Nor has VELCO performed such an analysis.)

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73. The Company asserts, rightfully, that in determining the economic usefulness of its Hydro-Québec Contract power, we must consider the costs of transmitting the alternative market power to VED. Citizens Brief at 52. However, for the same reasons that it is appropriate to include in the analysis all benefits to the Company from the Hydro-Québec Contract (such as its avoided line losses), it is equally appropriate—indeed, necessary—to include all costs associated with that Contract. Those costs include the Company's costs in upgrading its system to receive its deliveries under the Hydro-Québec Contract.

In Docket Nos. 5841/5859, we concluded that Citizens had failed in its obligation to perform least-cost analyses for a variety of transmission and distribution projects.<sup>74</sup> The evidence in the current proceeding demonstrates that again, this time with respect to transmission alternatives for the delivery of firm baseload power, Citizens failed to properly analyze its options. It is thus the Company's own fault that the necessary information is not available to quantify the comparative transmission costs for power delivered under the Hydro-Québec Contract and power delivered from domestic sources. Because the Company has not sufficiently supported its proposed transmission-cost adjustment to the cost of Hydro-Québec Contract power, we reject that adjustment.

*vii. Scheduling Benefit*

The Company asserts that an additional adjustment is needed in the comparison of Hydro-Québec Contract costs to market costs, to reflect scheduling benefits of the Hydro-Québec Contract power. However, both the Company and the Department have already calculated the value of these scheduling benefits and incorporated it into their market price estimates.<sup>75</sup> Because those benefits are already included in the comparison of Hydro-Québec Contract costs to market prices, we reject the Company's proposed additional adjustment for the same scheduling benefits.

Comparison of Value of Hydro-Québec Contract Power to Market Power

To analyze the economic usefulness of Citizens' purchases of Hydro-Québec Contract power, we start with the estimated prices for that power in the rate year (6.75¢ per kWh) compared to the estimated prices for market purchases (4.5¢ per kWh), which results in a higher price for Hydro-Québec Contract power of 2.25¢ per kWh. To account for the additional benefits to Citizens of the Hydro-Québec Contract purchases, we subtract from this price differential the estimated values of the following such benefits:

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74. Docket Nos. 5841/5859, Order of 6/16/97 at 186.

75. Chernick pf. at 44; Chernick reb. pf. at 18–19; tr. 4/11/02 at 52–54 (Biewald); exh. CCC-RBH-5.

Environmental benefits	0.25¢ per kWh
Line loss savings	0.15¢ per kWh
Additional wheeling revenues	0.4¢ per kWh
VELCO internal generation credit	0.2¢ per kWh
Secondary products from Hydro-Québec	0.45¢ per kWh
TOTAL	<u>1.45¢ per kWh</u>

These adjustments thus reduce the price differential between Hydro-Québec Contract power and market power by 1.45¢ per kWh, to 0.8¢ per kWh. Multiplying this price differential by the Company's expected purchases of Hydro-Québec Contract power in the rate year (187,718 MWh)<sup>76</sup> indicates that power to be above-market, after taking into account non-price benefits, by \$1.5 million in the rate year.

The economic usefulness doctrine, as we have traditionally articulated it, focuses on the economic value of the resource over its lifetime, and not only on its economic value during the period that the rates will be in effect. In this proceeding, we have been presented with two widely divergent analyses of the economic value of the Hydro-Québec Contract over its remaining life. The Department presented an analysis indicating that the Company's purchases under the Contract are expected to be above-market by approximately \$27.8 million dollars (in 2002 present-value dollars) over its remaining term. This analysis does not reflect any of the additional non-price benefits of the Hydro-Québec Contract.<sup>77</sup> The Company presented an analysis that relies on the Massachusetts externality adders to determine environmental benefits, but does not reflect values for the other non-price benefits of the Contract.<sup>78</sup>

We find both of the parties' analyses to be inadequate — the Department's for failing to reflect the non-price benefits that we have found appropriate, and the Company's for its flawed use of the Massachusetts externality adders. Despite its shortcomings, the Department's analysis nonetheless demonstrates that the price of the Company's remaining Hydro-Québec Contract purchases is highly likely to be well above market prices. Although the Company contends that

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76. Finding 27, above.

77. Tr. 4/11/02 at 35, 52 (Biewald).

78. Higgins reb. pf. at 23–27.

the non-price benefits of its Hydro-Québec Contract purchases will outweigh their substantially above-market price, it has failed to present evidence sufficient to support its contention.

Accordingly, based on the record before us, we conclude that Citizens' Hydro-Québec Contract purchases will be uneconomic by approximately \$1.5 million in the rate year. We further conclude that the Company has failed to demonstrate that the non-price benefits of the Contract over its life compensate for its uneconomic value in the rate year.

Our usual practice is to share a resource's above-market costs equally between ratepayers and shareholders, which in this case would result in a disallowance from VED's rates of \$750,000. The Company has argued that VED's financial integrity would be threatened if the Department's proposed Hydro-Québec Contract disallowance (\$3.8 million) were adopted by the Board, and that the Board should thus limit any such disallowance so that VED can, at a minimum, cover its operating expenses and interest expense.<sup>79</sup> Using the Company's methodology and its proposed expense figures, this minimum revenue requirement would be \$33.18 million.<sup>80</sup> Because an economic usefulness disallowance of \$750,000 is far smaller than the \$3.8 million disallowance proposed by the Department, and because the revenue requirement that we determine today (\$33.36 million) is greater than the Company's claimed minimum requirement, no forbearance would be justified even were we to accept the arguments of the Company and its witness.<sup>81</sup>

Because neither party has presented a sufficient reason for us to depart from our typical equal sharing of uneconomic costs between shareholders and ratepayers, we disallow \$750,000, i.e., one half of the used but not economically useful Hydro-Québec Contract costs in the rate year.

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79. *Laber reb. pf.* at 5–7; *Citizens Brief* at 52–56.

80. In its brief, the Company calculates this asserted minimum revenue requirement to be \$34.18 million. *Citizens Brief* at 54. However, in performing that calculation, the Company failed to reflect expense reductions of slightly over \$1 million to which it had agreed. *See Letter of June 19, 2002, from Scot L. Kline to Susan M. Hudson, Clerk of the Board.* Using the Company's corrected expense figures reduces the Company's asserted minimum revenue requirement by approximately \$1 million, i.e., to about \$33.18 million.

81. So that there is no misunderstanding, we note that we did not find those arguments to be persuasive. However, we need not address the substance of the arguments, because they do not apply in light of our treatment of the Company's Hydro-Québec Contract costs and other costs.

## **V. PROBLEMS WITH PLANT ACCOUNTS AND RELATED ISSUES**

We now turn to all the other contested issues, which combined have a smaller dollar value than the disputed amount of Hydro-Québec Contract power costs, but are nonetheless material.

There are several issues in this case related to possible changes to Citizens' plant accounts. These include:

- (1) how the results of the transmission and distribution ("T&D") audits conducted by Management Resources International Inc. (referred to herein as the "MRI Audits") should be reflected in Citizens' plant accounts and accumulated depreciation reserves;
- (2) whether and, if so, how, the results of Citizens' General Plant inventory should be reflected in Citizens' plant accounts and accumulated depreciation reserves;
- (3) whether Citizens' accumulated depreciation reserves should be rebalanced, and those rebalanced reserves used for the purpose of determining depreciation rates;
- (4) what is the appropriate depreciation expense for the rate year;
- (5) what is the appropriate average accumulated depreciation balance;  
and
- (6) whether the reserve for accumulated deferred income taxes should be adjusted to reflect the way in which the MRI Audits and General Plant inventories are reflected in Citizens' plant accounts and accumulated depreciation reserves.

Our decisions on these items are interrelated. Therefore, they are all addressed in this one section.

### **A. MRI Audits**

#### **Findings**

43. Citizens was required by the terms of probation established in Docket Nos. 5841/5859 to pay for independent, complete audits of the Company's transmission and distribution plant accounts. Docket Nos. 5841/5859, Order of 9/15/98 at 64–66 (probation terms 1(d) and 1(e)).

44. The required audits of Citizens' transmission and distribution plant accounts were performed by Management Resources International Inc. Schultz pf. at 7; exh. CCC-REW-2 at 1; Docket Nos. 5841/5859, Order of 2/17/99 at 1.

45. The MRI Audits included a physical inventory and the repricing of T&D assets to derive a new cost. Tr. 5/21/02 at 173 (Schultz).

46. Citizens and the Department have reached a settlement in principle regarding the T&D plant audit reports. As of the close of rebuttal hearings, this settlement had not been filed with the Board in this or any other docket. Doherty pf. at 6; Docket Nos. 5841/5859, Order of 5/29/02 at 3.

47. The settlement regarding the MRI Audits includes a "one-sided adjustment" that changes the values in the T&D plant accounts, but does not make any corresponding adjustments to accumulated depreciation. The terms of the settlement, including the "one-sided adjustment," are reflected in Citizens' original tariff filing. Doherty pf. at 5; tr. 5/21/02 at 176 (Schultz); tr. 5/21/02 at 99, 115 (White).

48. Usually, when retirements are posted to plant accounts, a corresponding adjustment is made to accumulated depreciation. There is no basis in accounting theory for making an adjustment for a retirement only to plant in service without a corresponding reduction to accumulated depreciation reserves. Tr. 5/21/02 at 100–101, 103–104, 116–117 (White); tr. 5/23/02 at 123 (Majoros).

### Discussion

Citizens' tariff filing reflects an agreement in principle between Citizens and the Department regarding the MRI Audits and appropriate T&D plant account balances and depreciation reserves. This settlement includes an unusual "one-sided adjustment" whereby retirements are posted to the plant accounts without making corresponding adjustments to accumulated depreciation. The settlement has not yet been filed with the Board,<sup>82</sup> so the Board has not yet had an opportunity to review the settlement in its entirety. Nevertheless, we will accept the "one-sided adjustment" agreed to in the settlement for the limited purpose of setting rates in this docket. We will consider the settlement in its entirety once it is filed in Docket Nos.

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82. In fact, the parties in Docket Nos. 5841/5859 recently asked the Board for an additional extension of time until August 1, 2002, to file the settlement. Letter from Victoria J. Brown, Esq., to Susan M. Hudson, Clerk, dated July 1, 2002, filed in Docket Nos. 5841/5859.

5841/5859, and our decision here should not be considered precedential with respect to those dockets.

## **B. General Plant Inventory**

### Findings

49. In response to a concern raised by the Department regarding two of VED's General Plant accounts, the Company conducted a physical inventory of all of VED's General Plant accounts. Doherty reb. pf. at 3; tr. 4/5/02 at 160–161 (Doherty); tr. 5/21/02 at 76 (Doherty).

50. Because of the timing of VED's General Plant inventory, the Department has not had adequate time to review it. Schultz reb. pf. at 6.

51. The results of VED's General Plant inventory should be accepted for the purpose of setting rates in this Docket. VED's General Plant account balances should be reduced by \$2,382,993 (over 45 percent of the Company's original request) to remove amounts for plant that is no longer in service. Doherty reb. pf. at 3; exh. CCC-1 at page 3 of Schedule B.1.

52. The General Plant inventory is different from the MRI Audits because it did not involve the repricing of assets. Tr. 5/21/02 at 173 (Schultz).

53. The unusual "one-sided adjustment" included in Citizens and the Department's settlement regarding the MRI Audits should not be extended to the General Plant inventory. Instead, accumulated depreciation should be reduced by \$2,382,993, an amount equal to the retirements posted to the General Plant accounts. Tr. 5/21/02 at 99–100 (White).

### Discussion

We continue to be troubled, as we were in Docket Nos. 5841/5859, by the problems uncovered by the Department and Citizens related to VED's plant accounts. Plant accounts *must* be properly maintained, both for the efficient operation of the business and for regulatory oversight and ratemaking. In Docket Nos. 5841/5859 we discovered serious problems with VED's transmission and distribution plant accounts, and we ordered that independent audits be conducted to determine the true balances of those accounts. The current rate case has clearly shown that the problems with VED's plant accounts extend beyond its T&D accounts. Citizens asserts that the General Plant inventory has fixed any problems with those accounts, but we

consider that inventory to be merely a first step. The Department has not had an opportunity to review the results of the inventory, and given Citizens' demonstrated inability to properly maintain its accounts, we consider the Department's review to be essential. While we will accept the results of the General Plant inventory as a known and measurable change for the purpose of setting rates in this docket (and therefore reduce VED's General Plant accounts by over 45 percent), we will review the adequacy of these adjustments in Docket Nos. 5841/5859. We are prepared to reduce the General Plant balances further, or take other appropriate action, if justified by our further review in those dockets.

We do not, however, accept the Department's recommendation that we require Citizens to reflect the results of the General Plant inventory through a "one-sided adjustment" similar to that made by Citizens to reflect the results of the settlement regarding the MRI Audits. We find that there is a significant difference between the MRI Audits and the General Plant inventory — the MRI Audits involved repricing of assets in addition to a physical inventory, while the General Plant inventory was only a physical inventory.<sup>83</sup> Given that fact, we do not see why the highly unusual treatment of accumulated depreciation in the settlement regarding the MRI Audits should be extended to the General Plant inventory. We recognize that ratepayers have probably paid more depreciation to date than they would have if the retirements to the General Plant accounts had been properly posted;<sup>84</sup> however, this will be balanced by ratepayers in the future paying less than they otherwise would have.<sup>85</sup> We do not condone this shifting of the timing of the depreciation expense, and we expect Citizens to properly maintain its plant accounts, including posting retirements when they occur, so that it does not happen again. Nevertheless, we are unable to conclude that the shifting of the timing of the expense is sufficient justification to take the highly unusual step of prohibiting Citizens from adjusting its

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83. *See*, findings 45 and 52, above.

84. Tr. 5/21/02 at 121–122 (White). Technically this would only be true if some of the retirements occurred before the last time Citizens' rates were set since it is expected that there will be retirements in between rate cases, but the amount of depreciation expense collected from ratepayers only changes as a result of a rate case. No evidence has been presented in this case regarding when the items in question actually were retired; the inventory simply showed that they are no longer in service today. However, the Company's own witness agreed that it is unusual for retirements of this magnitude to be posted in such a short period of time. Tr. 5/21/02 at 88 (Doherty). Therefore, we find it reasonable to conclude that ratepayers have paid more in depreciation expense than they would have if the retirements had been properly posted.

85. Tr. 5/21/02 at 121–122 (White).

accumulated depreciation to reflect the plant in the General Plant accounts that is no longer in service. Fundamentally, we think there is a basic need to set Citizens on a path to standard accounting practices, rather than to use atypical adjustments as rough offsets to continuing deficiencies. Therefore, we require Citizens to reduce by \$2,382,993 both the balances in its General Plant accounts and its accumulated depreciation associated with those accounts.

### **C. Depreciation Study**

#### **Findings**

54. Citizens was required by the terms of the Board's June 16, 1997, Order in Docket Nos. 5841/5859 to perform a depreciation study for VED. Docket Nos. 5841/5859, Order of 6/16/97 at 308 (Order paragraph 8).

55. A full depreciation study estimates parameters including a projection curve, a projection life, and a future net salvage ratio. These parameters are then combined into a depreciation rate through the selection of a depreciation system. White pf. at 6; tr. 4/11/02 at 93 (White); exh. CCC-REW-2 at 2.

56. A technical update retains the parameters that were estimated in a prior depreciation study, and updates depreciation rates for changes in the variables that are associated with the calculation of the remaining-life accrual rate. These variables include the age distribution of the surviving plant, the recorded depreciation reserve, and the average net salvage rate used in the calculation of a theoretical reserve. White pf. at 8; tr. 4/11/02 at 93–94 (White); exh. CCC-REW-2 at 7.

57. Citizens engaged Foster Associates to conduct a depreciation study in compliance with the Board's June 16, 1997, Order in Docket Nos. 5841/5859. White pf. at 3.

58. Citizens provided Foster Associates with December 31, 1999, age distributions from Citizens' new asset accounting system, and an update (through 1998) of the unaged database used in conducting VED's last depreciation study in 1993. White pf. at 7.

59. Foster Associates was unable to perform a full depreciation study because of a "discontinuity between the unaged data maintained in the legacy accounting system and the aged data maintained in the new system" which prevented the estimation of parameters. White pf. at 7; tr. 4/11/02 at 96 (White).

60. Instead, Foster Associates performed a technical update. It retained the parameters from VED's last depreciation study in 1993, and updated the depreciation rates for changes in the age distribution of Citizens' surviving plant, recorded distribution reserve, and the average net salvage rate used in the calculation of the theoretical reserve. The technical update used VED's current depreciation system which is composed of the straight-line method, broad group procedure, and remaining-life technique for all plant categories.<sup>86</sup> Tr. 4/11/02 at 94–95 (White); exh. CCC-REW-2 at 2–3, 7.

61. In the technical update, Foster Associates rebalanced (or redistributed) recorded reserves among primary accounts within each of the functional categories (such as Production, Transmission, Distribution, and General Plant). To perform the redistribution, Foster Associates multiplied the calculated reserve for each primary account within a function by the ratio of the function total recorded reserve to the function total calculated reserve. As a result, the sum of the redistributed reserves within a function is equal to the function total recorded depreciation reserve before the redistribution. However, Contributions-in-Aid-of-Construction reserves for T&D accounts were combined with the respective function plant reserves to achieve a rebalancing between the plant and Contributions-in-Aid-of-Construction reserves. White pf. at 10; tr. 4/11/02 at 134–135 (White).

62. Rebalancing reserves is a common practice in both full depreciation studies and technical updates. It is appropriate to rebalance reserves when there are large excesses and deficiencies in depreciation reserve accounts. Tr. 4/11/02 at 133 (White); tr. 5/21/02 at 135 (White).

63. Because VED's T&D plant accounts were adjusted to reflect the results of the MRI Audits (including transferring plant from one function to another), but no corresponding adjustment (or transfer) was made to accumulated depreciation, many accounts currently have excess or deficient reserves. For example, Account 371 Installations on Customers' Premises has a reserve ratio of 1,470 percent, Account 366 Underground Conduit has a reserve ratio of 107

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86. The Board accepted VED's current depreciation system in Docket No. 5656, although the Board did not specifically address the appropriateness of the system or consider alternative systems. Docket No. 5656, Order of 1/26/94 at 33–49, 106.

percent, and Account 345 Accessory Electric Equipment has a reserve ratio of just over 100 percent. Tr. 4/11/02 at 131–134 (White); tr. 5/21/02 at 135 (White); exh. Board-4 at 1.

64. It is appropriate to rebalance VED's depreciation reserves. Tr. 4/11/02 at 117–118 (White); findings 62–63, above.

65. It is common for depreciation studies to be conducted every three to five years. Majoros reb. pf. at 9; tr. 4/11/02 at 136 (White).

66. VED should have sufficient data available after three years to perform a full depreciation study. Tr. 4/11/02 at 139–140 (White).

### Discussion

In Docket Nos. 5841/5859, the Board ordered Citizens to conduct a new depreciation study. However, Citizens' consultant was unable to conduct such a study because of "discontinuities" in Citizens' plant accounting records. Specifically, the records from Citizens' old plant accounting system were unaged, while Citizens' new accounting system is maintaining aged records.<sup>87</sup> In this docket, no party has disputed the need to conduct a technical update instead of a full depreciation study. However, the Department has challenged one aspect of the methodology used in the technical update — the rebalancing or redistributing of the depreciation reserves.

A technical update is "largely a mechanical process," but the decision whether to rebalance the depreciation reserves requires the person performing the update to exercise his or her judgment.<sup>88</sup> One reason reserves are rebalanced is to correct large excesses or deficiencies in depreciation reserve accounts. Even the Department's depreciation witness acknowledges that it may be appropriate to "shift" reserves from one account to another to address the problem created by excessive depreciation reserves in a particular account.<sup>89</sup>

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87. "Aged" and "unaged" are terms of art. All transactions posted to aged records include information about the vintage year (the year the item was placed in service). This enables the calculation of exactly how long each retired item was in service. Transactions posted to unaged records do not include information about the vintage year; therefore, one knows how many items were retired, but cannot calculate how long each retired item was in service prior to retirement. Tr. 4/11/02 at 129–130 (White).

88. Tr. 4/11/02 at 106–107 (White).

89. Tr. 5/23/02 at 110–111 (Majoros).

In this case, because VED's plant accounts were adjusted to reflect the results of the MRI Audits, but no corresponding adjustment was made to accumulated depreciation, several of VED's plant accounts currently have either excess or deficient depreciation reserves.<sup>90</sup> Therefore, we find it reasonable to redistribute VED's depreciation reserves, and hereby adopt the depreciation rates calculated in Foster Associates' revised technical update (exhibit CCC-REW-3).<sup>91</sup>

The Department argues that VED's reserves should not be redistributed because: (1) redistributing reserves is not consistent with the generally accepted approach to technical updates since technical updates are based on current plant and reserve balances, not redistributed reserve balances; and (2) the inclusion of negative salvage factors is in doubt as a result of Financial Accounting Standard No. 143 and if these factors should not be included in the theoretical reserve calculation, another redistribution will be required in the future.<sup>92</sup>

We are not persuaded by these arguments. The Department's first argument directly contradicts Citizens' depreciation witness's testimony that rebalancing reserves is a common practice in technical updates;<sup>93</sup> we find Citizens' witness's testimony more persuasive on this point. As for the Department's second argument, we are unwilling to base our decision in this case on a situation that *might* occur in the future. If, at some point in the future, it is determined that negative salvage factors should not be included in the theoretical reserve calculation, we will deal with the issue and its effects on Citizens' depreciation rates at that time. In other words, despite the possibility that it could require a second redistribution of reserves, we are persuaded by Citizens' witness that frequent reserve redistributions are not a serious problem.<sup>94</sup>

We do, however, accept the Department's recommendation that we require Citizens to conduct a full depreciation study within three to five years. Both the Department and Citizens

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90. See, finding 63, above.

91. The only difference between Foster Associates' original technical update and its revised technical update is that the revised technical update reflects the results of VED's General Plant inventory. White reb. pf. at 5–6. Both the General Plant accounts and the accumulated depreciation associated with those accounts have been reduced by \$2,382,993. This is consistent with our decision regarding the treatment of the results of the General Plant inventory discussed in Section V.B, above.

92. Majoros reb. pf. at 5, 7–8.

93. See, finding 62, above.

94. Tr. 5/21/02 at 135–136 (White).

agree that it is common for depreciation studies to be conducted every three to five years. Citizens states that VED should have sufficient data for a full study to be conducted in another two to three years,<sup>95</sup> while the Department asserts that VED should have sufficient data in three to five years.<sup>96</sup> We, therefore, order Citizens to conduct a full depreciation study and file the results with the Board by December 31, 2005. If VED does not have sufficient data for a full study to be conducted by this date, Citizens must notify the Board as soon as possible, and no later than April 15, 2005.

#### **D. Depreciation Expense**

##### **Findings**

67. Citizens' original tariff filing included an adjusted test year VED depreciation expense of \$1,975,524. Doherty pf. at 14; exh. CCC-1 at Schedule C.2.

68. Citizens' adjusted test year VED depreciation expense should be reduced by \$151,424 to reflect the adjustments to General Plant and accumulated depreciation resulting from VED's General Plant inventory, and the revised depreciation rates calculated for the General Plant accounts. Doherty reb. pf. at 3; exh. KHD-1 at 2.

##### **Discussion**

Citizens and the Department use a similar methodology for computing the adjusted test year VED depreciation expense,<sup>97</sup> but they disagree on the two of the inputs into the formula: the balances in the General Plant accounts, and the depreciation rates. We have resolved each of these issues above.<sup>98</sup> Using the General Plant account balances that reflect the results of the General Plant audit, and the depreciation rates calculated by Foster Associates in its revised technical update, VED's adjusted test year depreciation expense should be reduced by \$151,424.

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95. Tr. 4/11/02 at 139–140 (White).

96. Majoros reb. pf. at 9.

97. The formula for calculating annual depreciation expense is shown on exh. CCC-1 at Schedule C.2. The Department has proposed making additional adjustments after this calculation is performed. These adjustments are discussed below.

98. See, finding 51 and the discussion in Section V.C, above.

Because the Department recommends not using General Plant account balances that reflect the results of the General Plant audit, it proposes additional adjustments to depreciation expense to remove the depreciation expense associated with the plant that is no longer in service. Specifically, the Department proposes removing (1) \$24,042 in depreciation expense for computer equipment;<sup>99</sup> (2) \$1,780 in depreciation expense on the communication equipment that is no longer in service; and (3) \$18,638 in depreciation expense for other General Plant that is no longer in service.<sup>100</sup> Since we have already determined that the General Plant account balances used to calculate depreciation expense should reflect the results of the General Plant audit, there is no need to make the additional adjustments proposed by the Department, and we hereby deny them.

## **E. Accumulated Depreciation**

### **Findings**

69. Citizens' original tariff filing does not account for interim period depreciation in its accumulated depreciation balance. Schultz pf. at 3.

70. Citizens' accumulated depreciation balance should be increased by \$4,548,839 to reflect interim period depreciation. Schultz pf. at 3.

71. The depreciation expense included in the rate year must be recognized, in part, as an offset to rate base by increasing the average accumulated depreciation. Schultz pf. at 6.

72. The steps to follow to calculate the rate year adjustment to accumulated depreciation are:

- Add rate year depreciation to accumulated depreciation at June 30, 2002, to determine accumulated depreciation at June 30, 2003;
- Average accumulated depreciation at June 30, 2002, and accumulated depreciation at June 30, 2003, to determine average rate year accumulated depreciation;

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99. This is all of the depreciation expense for computer equipment. The Department bases this adjustment on its assertion that if the computer equipment plant accounts and accumulated depreciation are adjusted to remove the plant that is no longer in service, by the time new rates go into effect, the computer equipment account as a whole will be significantly over-depreciated. Schultz pf. at 9; exh. DPS-HWS-1 at page 2 of Schedule B-2.

100. Department Brief at 61.

- Subtract average rate year accumulated depreciation from average interim year accumulated depreciation to determine the rate year adjustment to accumulated depreciation.

Exh. DPS-HWS-2 at Schedule B-1 revised; exh. KHD-2 at 1.

73. Accumulated depreciation at June 30, 2002, is \$29,777,855. Exh. DPS-HWS-2 at Schedule B-1 revised.

74. Average interim year accumulated depreciation is \$28,471,138. Exh. DPS-HWS-2 at Schedule B-1 revised.

75. Average accumulated depreciation should be increased \$2,218,767 to reflect depreciation during the rate year. Findings 67, 68, and 72–74, above.

76. Citizens' average accumulated depreciation, after making all appropriate adjustments, is \$28,306,912. Exh. CCC-1 at Schedule B; findings 53, 70, and 75, above.

### Discussion

Citizens acknowledges that its accumulated depreciation balance should be adjusted for depreciation included in rates for the interim period between the end of the test year and the beginning of the first year of the new rates.<sup>101</sup> However, Citizens disagrees with the Department's proposed methodology for calculating this adjustment. The Department bases its adjustment on the amount of depreciation recorded on Citizens' books for 2000.<sup>102</sup> Citizens asserts that the adjustment should be based on the actual amount of depreciation expense included in rates during the interim period.<sup>103</sup> We are persuaded that the Department's

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101. Tr. 5/21/02 at 73 (Doherty).

102. Citizens recorded \$2,613,434 in depreciation expense on its books in the year 2000. To calculate the interim period accumulated depreciation adjustment, the Department began with Citizens' accumulated depreciation balance as of December 31, 2000, \$25,857,704, and added one-half of the depreciation recorded in the year 2000 to arrive at the June 30, 2001, balance of \$27,164,421. Next, the Department added the full amount of the depreciation recorded in the year 2000 to arrive at the June 30, 2002, balance of \$29,777,855. The June 30, 2001, and June 30, 2002, balances were then averaged to arrive at \$28,471,138. The difference between this and Citizens' proposed average balance of \$23,922,299 is \$4,548,839, which is the amount of the Department's proposed adjustment. Schultz pf. at 3–5; exh. DPS-HWS-2 at Schedule B-1 revised.

103. The last time Citizens' depreciation expense was reviewed, the Board used a test year that ended December 31, 1995, and allowed annual depreciation expense of \$2,181,787. To calculate the interim period depreciation in the current case, Citizens determined the average depreciation expense per customer, based on the customer levels at the end of the test year in the prior case (\$109 per customer). Then Citizens multiplied this amount

(continued...)

methodology for determining interim period depreciation is the correct one. We agree with the Department that Citizens' use of depreciation allowed in the last litigated proceeding ignores changes in revenue, plant and depreciation since the 1995 proceeding, ignores the 2000 depreciation expense recorded on the books, and would, in effect, ignore regulatory accounting treatment of depreciation and accumulated depreciation that has been practiced for years.<sup>104</sup> Even the Company admits that it is not aware of any rate proceeding in which its methodology has been accepted.<sup>105</sup>

Citizens also acknowledges that accumulated depreciation should be adjusted to reflect depreciation included in rates during the first year of new rates.<sup>106</sup> Citizens and the Department agree on the methodology to be used to calculate this adjustment.<sup>107</sup> We have already determined the three inputs necessary to calculate the rate year adjustment.<sup>108</sup> Using these inputs, we calculate the rate year adjustment to accumulated depreciation as follows:

- Add rate year depreciation (\$1,824,100) to accumulated depreciation at June 30, 2002, (\$29,777,855) to determine accumulated depreciation at June 30, 2003, (\$31,601,955);
- Average accumulated depreciation at June 30, 2002, (\$29,777,855) and accumulated depreciation at June 30, 2003, (\$31,605,955) to determine average rate year accumulated depreciation (\$30,689,905); and
- Subtract average rate year accumulated depreciation (\$30,689,905) from average interim year accumulated depreciation (\$28,47,138) to determine the rate year adjustment to accumulated depreciation (\$2,218,767).

Thus, we make three adjustments to VED's accumulated depreciation: (1) a \$2,382,993 reduction to reflect the results of the General Plant inventory; (2) a \$4,548,839 increase to reflect

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103. (...continued)

by the average number of VED customers for 2001 (which the Company used to represent an average number of customers for the 18-month interim period in this proceeding). This resulted in an annual depreciation expense of \$2,264,090, or a total of \$3,396,135 for the entire interim period. Doherty reb. pf. at 6–7.

104. Schultz reb. pf. at 9–10.

105. Tr. 5/21/02 at 73 (Doherty).

106. Exh. KHD-2 at 1.

107. See finding 72, above.

108. Rate year depreciation = \$1,824,100 (See, findings 67 and 68, above). Accumulated depreciation at June 30, 2002 = \$29,777,855 (See, finding 73, above). Average interim year accumulated depreciation = \$28,471,138 (See, finding 74, above).

interim period depreciation; and (3) a \$2,218,767 increase to reflect rate year depreciation.<sup>109</sup> Combined, these adjustments will reduce Citizens' annual cost of service by \$377,289 (pre-tax).

## **F. Deferred Income Taxes**

### **Findings**

77. In its original tariff filing, Citizens reduced rate base by \$4,360,572 to reflect the reserve for accumulated deferred income taxes. When Citizens calculated this figure, it included a reduction of \$581,342 to recorded accumulated deferred income taxes for 1999 and 2000 to reflect the results of the MRI Audits. Apuzzo pf. at 4; exh. CCC-1 at Schedules B and B.4.

78. The Internal Revenue Service's ("IRS") tax normalization rules require companies to use consistent estimates and projections with respect to tax expense, depreciation expense, reserve for deferred taxes, and rate base. Apuzzo reb. pf. at 2.

79. Not including Citizens' proposed adjustment to the reserve for accumulated deferred income taxes to reflect the results of the MRI Audits would appear to violate the IRS's normalization rules. Apuzzo reb. pf. at 2.

80. If the IRS's normalization rules are violated, the reserve for deferred income taxes associated with accelerated depreciation (over \$3.6 million) would be eliminated. This would increase rate base and increase the level of total income tax expense recoverable in rates. Apuzzo reb. pf. at 3.

81. Citizens' proposed \$581,342 decrease to the reserve for accumulated deferred income taxes to reflect the results of the MRI Audits is appropriate. Findings 77–80.

82. Citizens' reserve for accumulated deferred income taxes should be increased by \$32,807 to reflect the results of VED's General Plant inventory. Apuzzo reb. pf. at 4.

### **Discussion**

Citizens and the Department disagree on whether accumulated deferred income taxes should be affected by the adjustment made to reflect the results of the MRI Audits. Citizens

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109. See, findings 53, 70, and 75.

argues that an adjustment to accumulated deferred income taxes is necessary to comply with the IRS's normalization rules. The Internal Revenue Code provides that:

The procedures and adjustment which are to be treated as inconsistent . . . shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's *tax expense, depreciation expense, or reserve for deferred taxes* . . . unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

26 U.S.C. § 168(i)(9)(B)(ii) (emphasis added).

According to Citizens, because the one-sided adjustment made to reflect the results of the MRI Audits does not allow recovery of the depreciation expense on the T&D plant adjustment, the reserve for deferred taxes on the T&D plant adjustment must also be removed or the IRS's normalization rules will be violated. If the IRS's normalization rules are violated, the reserve for deferred income taxes related to accelerated depreciation (approximately \$3.6 million) would need to be eliminated, and the revenue requirement in this case would be significantly increased.<sup>110</sup>

The Department, on the other hand, asserts that ratepayers pay deferred income taxes in advance, and are entitled to earn a return on that advance payment until the Company actually pays the taxes that were deferred.<sup>111</sup> In addition, the Department argues that the adjustment made to reflect the MRI Audits is a unique circumstance that could impact the normalization issue. Consequently, the Department recommends that Citizens obtain a Private Letter Ruling from the IRS.<sup>112</sup>

We are persuaded by Citizens' arguments. The language from the Internal Revenue Code regarding normalization quoted above indicates to us that depreciation expense and reserve for deferred taxes should be treated in a similar manner. That means that once the plant is removed for ratemaking purposes, it is proper to remove the effect of the plant on accumulated deferred income taxes. Therefore, we find that Citizens' proposed \$581,342 reduction to the reserve for accumulated deferred income taxes to reflect the results of the MRI Audits is appropriate.

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110. Apuzzo reb. pf. at 2–3.

111. Schultz pf. at 13.

112. Schultz reb. pf. at 31.

However, we recognize that the IRS is the agency best equipped to interpret its normalization rules. Consequently, we direct Citizens to file a clear and neutral request for a Private Letter Ruling from the IRS on the proper treatment of accumulated deferred income taxes in this circumstance. We require Citizens to submit the request to the IRS within 45 days of this Order and to obtain the agreement of the Department on the form and content of the request before submitting it. If the resulting IRS Private Letter Ruling states that the Department's proposed treatment of deferred income taxes would not violate the IRS's normalization rules, we invite the Department to ask us to revisit this issue on a prospective basis at that time (ideally any such reconsideration would occur before the conclusion of the proceedings in Docket Nos. 5841/5859).

Citizens also asserts that the reserve for accumulated deferred income taxes should be increased by \$32,807 to reflect the results of the General Plant inventory. The Department has not challenged this adjustment, but it has questioned why Citizens' adjustment to reflect the results of the MRI Audits is a reduction to the reserve while Citizens' adjustment to reflect the results of the General Plant inventory is an increase to the reserve.<sup>113</sup> Citizens has responded that the difference results from the "one-sided adjustment" made to reflect the MRI Audits, while the General Plant inventory was reflected through a traditional adjustment to both plant balances and accumulated depreciation.<sup>114</sup> We are persuaded by this explanation, and hereby accept Citizens' proposed \$32,807 increase to the reserve for accumulated deferred income taxes to reflect the results of the General Plant inventory.

## **VI. DSM AND ACE**

### **Findings**

83. Citizens originally requested recovery of \$2,661,023 in Demand-Side Management ("DSM") costs and \$696,785 in Account Correcting for Efficiency ("ACE") costs for the period from January 1, 1999, through June 30, 2001. Citizens also requested \$295,042 in Allowance

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113. The Department suggests that both adjustments should result in an increase to the reserve. Schultz reb. pf. at 31.

114. Tr. 5/22/02 at 65-66 (Apuzzo).

for Funds Used During Construction ("AFUDC") costs associated with the DSM costs and \$200,300 in cost of capital used to fund shared-savings loans. Exh. CCC-1 at Schedule B.7.

84. Citizens' requested DSM costs should be reduced by \$79,944 to reflect a rebate received from the National Exchange Carrier Association, and by \$18,785 to reflect an invoice incorrectly charged to Citizens' Vermont Electric Division. Citizens' requested AFUDC costs should be reduced by \$6,230 in carrying costs associated with those amounts. Lahar reb. pf. at 1–2; Parlin pf. at 10.

85. Citizens' requested ACE costs should be reduced by \$3,907 to (1) correct an error in data entry, (2) correct an overstatement of lighting savings for one project, (3) reflect the Board's determination of the actual kWh savings that resulted from activities performed by Efficiency Vermont in Citizens' service territory,<sup>115</sup> and (4) to make similar changes to the savings from the same measures installed by Citizens' subcontractor prior to Efficiency Vermont's creation. Parlin pf. at 12; Parlin reb. pf. at 3; Lahar reb. pf. at 2; tr. 5/21/02 at 22–24 (Lahar); exh. DPS-KEP-5A.

86. Citizens should recover \$2,562,294 in DSM costs and \$692,878 in ACE costs for the period from January 1, 1999, through June 30, 2001. Citizens should also recover \$288,812 in AFUDC costs associated with the DSM costs and \$200,300 in cost of capital used to fund shared savings loans. Findings 83–85, above.

87. The Partial Stipulation on Remedial Demand-Side Management Programs ("DSM Stipulation") provides that:<sup>116</sup>

- Citizens will not seek recovery of any marketing costs associated with the Residential Incentives to Save Energy ("RISE") Program.

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115. The Board made this determination in a letter dated July 8, 2002, from Michael H. Dworkin, Chair, Public Service Board, to Beth Sachs, Vermont Energy Investment Corporation. In this letter, the Board accepted the Energy Efficiency Utility Contract Administrator's recommendation regarding Efficiency Vermont's energy savings for 2001. During the rebuttal phase of this case, Citizens and the Department agreed that if the Board accepted the Contract Administrator's recommendation, Citizens' ACE costs should be adjusted accordingly. Tr. 5/21/02 at 22 (Lahar); tr. 5/23/02 at 232–233 (Parlin).

116. The Board's 9/15/98 Order in Docket Nos. 5841/5859 incorporates the terms of the DSM Stipulation into the terms of probation. Docket Nos. 5841/5859, Order of 9/15/98 at 71.

- Citizens will not seek recovery of 50 percent of the audit costs associated with the RISE Program.
- "Incentive costs (defined as the utility's share of the cost of installed measures) and other necessary costs prudently incurred in connection with the [RISE] Program will be subject to the Vermont Public Service Board's provisions for ratemaking treatment for DSM expenditures, except that any cost incurred to undo or correct measures installed under prior programs shall not be recoverable. In addition, to the extent that costs incurred in connection with the [RISE] Program duplicate costs currently excluded from rates by the PSB Order of June 16, 1997, the Company shall not seek to recover such currently excluded costs. The parties agree that ratepayers should pay only once for delivery of a quality DSM program."

The DSM Stipulation does not specifically mention administrative and program development costs associated with the RISE Program. Exh. CCC-3 at 2.

88. Updating VED's DSM tracking database to accommodate VED's new account numbers will be a relatively simple task. Tr. 4/5/02 at 40–41 (Lahar).

### Discussion

Citizens implemented several DSM programs during the period January 1, 1999, through June 30, 2001.<sup>117</sup> The Department admits that Citizens appears to have provided effective DSM services through these programs.<sup>118</sup> However, the Department challenges the recovery of some of the costs requested by Citizens. Citizens agrees with some of the DPS's proposed adjustments. These are listed in Findings 84 and 85, above. We find these adjustments to be reasonable, and hereby accept them.

The Department also proposes disallowing recovery of \$40,704 which Citizens paid to Optimal Energy for certain program design activities related primarily to Citizens' Commercial Lost Opportunity Program.<sup>119</sup> The Department asserts that these costs should be disallowed as "probation-related"; the basis for this claim is that they were incurred to fix a problem that the Department noticed when it reviewed one of the quarterly reports that Citizens was required to

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117. In addition, Efficiency Vermont, Vermont's statewide energy efficiency utility, began delivering certain DSM programs in Citizens' service territory on March 1, 2001.

118. Parlin pf. at 3.

119. Less than ten percent of these costs were charged to Citizens' RISE program. Parlin reb. pf. at 8.

file under the terms of its probation.<sup>120</sup> According to the Department, this chain of events makes the costs probation-related, and therefore ineligible for recovery under the terms of Citizens' probation.<sup>121</sup> We find this argument unpersuasive. Just because the Department noticed a problem when it reviewed a quarterly DSM report (the filing of which is required by a term of probation), instead of Citizens' annual DSM report (which all utilities in the state are required to file), does not mean that the costs of correcting the problem are related to probation. The Department does not dispute that the work was performed, nor does it dispute that the work appropriately addressed the Department's concern.<sup>122</sup> Therefore, we find that Citizens should be allowed recovery of the \$40,704 expense.

In addition, the Department's position on the Optimal Energy costs casts significant doubt on the credibility of the overall allocation concept applied by the Department's DSM witness. The Department's witness, as noted in the preceding paragraph, showed a fundamental misunderstanding of the proper way to determine which DSM costs are related to probation and which are not. As a result, we cannot rely upon her testimony to support the Department's recommendation that Citizens be denied recovery of:

- All RISE administrative costs (\$148,100);<sup>123</sup>
- One-half of all RISE program development costs (\$27,107);
- \$1,188 in costs which the Department alleges are marketing costs (and therefore ineligible for recovery under the terms of the DSM Stipulation); and
- Half of the estimated audit and administrative costs and all of the estimated marketing costs for 79 customers who participated in Citizens' original Residential

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120. Tr. 5/23/02 at 227–229 (Parlin).

121. Probation term (k) states, in part, "Citizens must pay the full costs of this probation, and none of the costs may be recovered in VED's retail rates." Docket Nos. 5841/5859, Order of 9/15/98 at 72.

122. Tr. 5/23/02 at 227–229 (Parlin).

123. The Department also points out that Citizens' administrative costs include \$2,163 in costs related to the subcontractor implementing the RISE Program's work with the Special Master. Exh. KEP-8 at 15–16. Citizens responds that the recovery of these costs should be governed by the DSM Stipulation, and since the DSM Stipulation does not specifically exclude them, they are appropriately included in administrative costs. Lahar reb. pf. at 4. We are persuaded by this argument. In general, all costs associated with the Special Master are not recoverable from ratepayers. However, the DSM Stipulation is the governing document with respect to recovery of costs associated with the RISE program, and we agree with Citizens' interpretation of the DSM Stipulation on this point.

Retrofit Program and therefore were eligible to be served in the RISE program, but instead were served through other residential audit-driven programs (\$19,750).<sup>124</sup>

We hereby deny those four proposed adjustments.

Two of the Department's assertions deserve additional comment. First, the Department argues that according to the terms of the DSM Stipulation, all of the administrative costs and half of the program development costs associated with the RISE program should not be recovered because they duplicate costs associated with Citizens' earlier inadequate DSM program. However, our reading of the DSM Stipulation does not support the Department's interpretation. The DSM Stipulation clearly specifies how marketing, audit, and incentive costs associated with the RISE program will be treated for cost recovery purposes.<sup>125</sup> It also states that "other necessary costs prudently incurred in connection with the [RISE] Program will be subject to the Vermont Public Service Board's provisions for ratemaking treatment for DSM expenditures."<sup>126</sup> Since the DSM Stipulation does not specifically address administrative or program development costs, we consider these costs to be examples of "other necessary costs." The Department has not challenged the prudence of these costs, therefore they should be allowed to be recovered.

Second, the Department asserts that Citizens should not be allowed to recover half of the estimated audit and administrative costs and all of the estimated marketing costs for 79 customers who participated in Citizens' original DSM program and therefore were eligible to be served in the RISE program, but instead were served through other residential audit-driven programs. According to Citizens, one of the reasons this occurred is that many of the 79 accounts were residential apartments, and Citizens had a protocol to work efficiently with landlords of multi-unit dwellings: if 50 percent or more of the units at a facility had participated in the earlier DSM program, all the units were served through RISE, but if less than 50 percent had participated previously, all were served through Citizens' Residential High Use Program or, if eligible, the Low Income Residential Program.<sup>127</sup> We find this approach to be reasonable.

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124. Parlin pf. at 3–4, 8–9; exh. DPS-KEP-4A.

125. *See*, finding 87, above.

126. Exh. CCC-3 at 2.

127. A second reason is that some of those 79 customers had requested service through the original DSM program, but were never actually served, and therefore were outside the group of customers that the RISE program was intended to re-serve. Lahar reb. pf. at 9–10.

DSM programs should not be designed or implemented in such a manner that they create barriers to participation by customers. Requiring landlords of multi-unit dwellings to understand that a single property must be "divided" for purposes of receiving energy efficiency services, with different parts eligible for different incentives is such a barrier.<sup>128</sup> The goal behind requiring Citizens to implement the RISE program was to ensure that customers who received inadequate service in the past were re-served through a well-designed DSM program. Significantly, the Department does not contest whether the customers were served again or not, but merely the program under which they were served.<sup>129</sup> We are not persuaded this would be a good reason to disallow some of the costs associated with serving these 79 customers.

In sum, we conclude that Citizens should be allowed to recover a total of \$3,744,284 in DSM, ACE, AFUDC, and cost of capital used to fund shared savings loans.<sup>130</sup> Citizens has requested recovery of its DSM-related costs over a five-year period.<sup>131</sup> The Department has not challenged the recovery period, and it is consistent with prior Board determinations. Therefore, we approve this recovery period, and order that Citizens' rates include \$748,857 in DSM-related expenses for the period January 1, 1999, through June 1, 2001, with the remaining \$2,995,427 included in rate base as deferred costs so that the total amount will be amortized over a five-year period.<sup>132</sup>

The Department raises one additional issue related to DSM that we find has merit. The Department points out that VED's DSM database has not yet been updated to accommodate VED's new account numbers. As a result, Citizens is unable to put in VED's DSM database the

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128. The Department's witness's response to this issue was "I understand Mr. Lahar's discussion of the logistical issues that can arise from implementing a remedial program, however, they do not seem to be an overwhelming obstacle to ensuring that all RISE-eligible sites were provided comprehensive audits and incentives as is consistent with the mandate from the Board to provide remedial services through the RISE program." Parlin reb. pf. at 9–10. We disagree. While the "logistical issues" might not be an "overwhelming obstacle" from the Company's perspective, they very well might be from a customer's perspective.

129. In addition, the Department notes that the services provided to customers through the program under which they were served are "very similar" to those provided to customers through the RISE program, although it did not know whether the incentives were the same. Tr. 5/23/02 at 220–221 (Parlin).

130. This figure includes \$2,562,294 in DSM costs and \$692,878 in ACE costs for the period from January 1, 1999, through June 30, 2001, \$288,812 in AFUDC costs associated with the DSM costs, and \$200,300 in cost of capital used to fund shared savings loans, as stated in finding 86, above.

131. Lahar pf. at 3.

132. These amounts are in addition to the remaining amounts for Citizens' earlier DSM expenditures which are addressed in Section VIII.E, below.

detailed information provided by Efficiency Vermont regarding VED's customers served through its DSM programs. Instead, Citizens consolidated the activity and assigned artificial account numbers to each of the records. This approach is sufficient for calculating a proxy value of ACE for Efficiency Vermont's programs, but is not adequate for other DSM tracking purposes, such as distributed utility planning and responding to customers' inquiries.<sup>133</sup> Citizens acknowledges that changing VED's database to accommodate VED's new account numbers will be relatively simple, and states that it is intending to make this change.<sup>134</sup> We require Citizens to make this change within 60 days of the date of this Order, and to notify the Board and the Department when the update is complete.

## **VII. DEFERRED COSTS AND AMORTIZATIONS**

### **A. IRP Costs**

#### **Findings**

89. Citizens' original tariff filing includes \$440,281 in deferred costs incurred between 1996 and 1998 associated with the preparation of its Integrated Resource Plan ("IRP"). The Company was able to provide supporting documentation for only \$311,838 of those costs. Schultz pf. at 16.

90. Included in the undocumented costs are \$1,934 in office supplies, which the Department is not challenging. Schultz pf. at 16.

91. The appropriate amortization period is five years. Doherty pf. at 12.

92. After reducing the deferred costs for undocumented IRP expenses (other than office supplies), the appropriate level of IRP expenses to be included in annual rates is \$62,754. Schultz pf. at 15–16.

#### **Discussion**

The Company deferred \$440,281 in costs it claims to have incurred in preparation of its last IRP. The Department is contesting \$126,509 of these costs which Citizens claims were for outside consultants but for which Citizens could not provide any supporting documentation.

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133. Parlin pf. at 13–15.

134. Tr. 4/5/02 at 40–41 (Lahar).

Citizens, like all utilities, has the responsibility to provide adequate and reliable documentation to support the rate base figures used to calculate allowable amortization expenses. Due to the lack of such documentation, we are disallowing the unsupported consultant costs, and find that the appropriate amount of IRP costs to be amortized is \$313,772.

Citizens and the Department agree that the appropriate amortization period is five years. Therefore, one-fifth of \$313,772 is the appropriate amount of IRP amortization expense to be included in rates. This is a \$25,302 reduction to Citizens' requested IRP amortization expense.

## **B. PCB Costs**

### **Findings**

93. From 1994 to 1999, Citizens spent \$1,116,399 on PCB clean-up at its Pine Hill warehouse site. Exh. DPS-23.

94. In Docket Nos. 5841/5859, the Board approved the future recovery in rates of \$707,427 spent on PCB clean-up at the Pine Hill warehouse site. Docket Nos. 5841/5859, Order of 6/16/97 at 21, 26.

95. The Pine Hill warehouse continues to be used by Citizens' VED, and is included in its rate base. Tr. 5/21/02 at 74 (Doherty).

96. Citizens' prior classification of PCB expenditures as plant in service was inaccurate. The unrecovered portion of these costs — \$1,042,119 — has been removed from plant in service. Doherty pf. at 10–11; exh. CCC-1 at schedule B. 10; White reb. pf. at 3.

97. Since correcting for the misclassification, the appropriate mechanism for recovery of the unearned portion of PCB costs is amortization, not depreciation. Doherty pf. at 11.

98. There is no basis for a change in the approximate 50-year recovery period for unrecovered PCB clean-up costs, given prior treatment of these expenses in Docket Nos. 5841/5859 and the nature of these deferred costs. Schultz reb. pf. at 18.

99. Citizens will have booked an additional \$43,755 in depreciation expense related to PCB plant-in-service assets through July 1, 2002. Exh. DPS-HWS-2 at Schedule B-6.

100. After deducting interim period depreciation expense, the remaining unamortized balance of PCB clean-up costs is \$977,399. Schultz reb. pf. at 17.

101. A reasonable level of PCB amortization expense is \$20,966 based on a continuation of the current write-off rate of 2.1 percent. Exh. DPS-HWS-2 at Schedule B-6.

### Discussion

At dispute is the amount of PCB costs included in rate base, and the appropriate period over which to recover these costs.

Citizens' filing is based on total PCB clean-up costs of \$1,116,399, adjusted for depreciation recoveries through December 2000 at a 2.1 percent rate, and thereafter uses a five-year amortization period, equivalent to a 20 percent rate. Citizens justifies use of a five-year amortization period as being consistent with the recovery period for DSM and unusual storm costs. Using this approach, Citizens calculates net unrecovered PCB costs of \$1,042,119, and has included one-fifth of this amount (\$208,424) in rate year amortization expense. There remains, according to Citizens, an unrecovered PCB balance of \$833,695.

In contrast, the Department is basing its calculation of unrecovered PCB clean-up expenses on the continued application of the 2.1 percent recovery rate to the entire amount of expenses Citizens incurred for PCB clean-up until the start of the rate year. This methodology results in the Department's recommendation of \$977,399 of unrecovered PCB costs, and an allowable rate year amortization expense of \$20,966.

In its June 16, 1997, Order in Docket Nos. 5841/5859, the Board approved the future recovery in rates of \$707,427 spent on PCB clean-up at the Pine Hill warehouse site. The clean-up was necessitated after PCB-contaminated transformer oil was spilled into a floor drain in March 1988. (Subsequent to the June 1997 Order, Citizens incurred, and deferred, an additional \$408,972 in PCB clean-up costs.) Under the Board's treatment in Docket Nos. 5841/5859, PCB clean-up costs were allowed to be recovered since the clean-up expenses were not proven to be the result of the Company's imprudence, and on the premise that they would extend the useful life of an existing Company asset.<sup>135</sup> The costs were booked to plant in service, and depreciated using a rate which would result in full recovery in 50 years.

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135. Order of 6/16/97 at 26; tr. 4/5/02 at 146-47 (Doherty).

The report on the MRI distribution audit stated that the classification of the PCB clean-up expenditures as plant in service was in error since there were no physical distribution assets involved. In compliance with the MRI distribution audit's recommendation, these costs have been removed from Account 361.<sup>136</sup> Citizens has used the reclassification of these costs as an excuse to revisit the issue of an appropriate recovery period.

We are not persuaded by Citizens' argument for a change from the current 50-year recovery period to a five-year recovery period. The Company's arguments that these costs should be accorded accelerated amortization due to the MRI distribution audit's reclassification are weak. There is no tie between the timing of the cash expenditure for the PCB clean-up and the recovery of those funds. The Company also has not supported its position using cost allocation or depreciation accounting theory. Instead, the Company cites Board approval of five-year recovery periods for DSM and deferred storm costs to support a five-year amortization period for its PCB clean-up expenses.

We find the Company's citations to prior DSM and deferred storm cost recovery periods to be irrelevant. In determining the appropriate recovery period, long-standing Board practice is to evaluate each deferral individually. Such evaluation may take into consideration the nature of the expenditure, the expected degree of its "extraordinariness," the frequency of reoccurrence, and the period over which ratepayers will benefit from the expenditure, or, in some cases, the extension of an asset's useful life. In this case, the warehouse is currently in use, and the clean-up of the underlying land theoretically returns it to its previous value.

We similarly reject Citizens' alternative proposal to treat these costs as a removal expense, which would then be charged to the depreciation reserve; we do so because the ongoing value of the clean-up is more closely related to the value of the real estate than to removal.<sup>137</sup> Under this treatment, a rebalancing or redistribution of the recorded reserve for the distribution function would address the absence of a plant balance. The result would be that unrecovered PCB costs would be allocated to operations over approximately 17 years.

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136. Tr. 4/5/02 at 146 (Doherty).

137. White reb. pf. at 4; tr. 4/5/02 at 148–49 (Doherty).

Instead, we adopt the Department's recommendation, and find it is appropriate to continue to recover the unrecovered PCB costs over a 50-year period, using a 2.1% amortization rate.

Next we examine what is the amount of unrecovered PCB clean-up costs. The Department is correct that in order to determine the unrecovered PCB costs, interim period depreciation expense should be added to depreciation expense through the end of the rate year. This total figure should then be subtracted from total PCB costs. Following this formula, we determine that the amount of unrecovered PCB costs is \$977,399. Applying the 2.1% amortization rate to this amount, we find that \$20,966 should be included in Citizens' cost of service as PCB clean-up cost amortization expense.

### **C. Hydro-Québec Arbitration Costs**

#### **Findings**

102. On behalf of the Vermont Joint Owners, VELCO filed suit against Hydro-Québec following the 1998 ice storm in the hope of voiding the Hydro-Québec Contract, or reducing power costs associated with it. (This lawsuit is hereafter referred to as the "Hydro-Québec Arbitration.") Kellogg pf. at 13.

103. Citizens' proportionate share of the cost of the Hydro-Québec Arbitration was \$1,453,868. The Company recovered \$886,935 of its share of the expenses through the Hydro-Québec Arbitration settlement. *Id.*

104. The Company booked the unrecovered balance of \$567,433 to a deferral account. An October 13, 2000, letter from the Board allowed such treatment. *Id.*

105. The accounting order does not bar any party from contesting, or the Board from determining or disallowing, the reasonableness or prudence of such costs or the ratemaking treatment for such costs in whole or in part in any rate proceeding. Exh.-DPS.-27 at ¶ 4.

106. The appropriate period of recovery of the deferred costs is tied to the remaining length of Citizens' Hydro-Québec contracts. These contracts extend to 2012, 2015, and 2020. Schultz pf. at 20–21.

107. A ten-year amortization period approximates the shortest remaining contract life. Using a ten-year recovery period results in rate year Hydro-Québec Arbitration expense of \$56,743. *Id.*

108. The remaining unamortized portion of the Hydro-Québec Arbitration expense to be included in rate base and recovered over nine more years is \$510,690. *Id.*

### Discussion

Citizens' position is that it should be allowed to recover the full amount of the Hydro-Québec Arbitration costs over a five-year period. The Company refers to prior Board decisions dealing with amortization periods with respect to the reasonableness of the arbitration suit,<sup>138</sup> and the precedent for a five-year amortization period. Using this approach, Citizens listed \$113,487 in Hydro-Quebec Arbitration amortization expense in the rate year, and included the remainder (\$453,946) in rate base.

The Department is recommending a ten-year amortization period, reducing rate year Hydro-Québec Arbitration amortization expense to \$56,743. The Department also contends that Citizens is not entitled to earn a return *on* the unamortized balance, and thus recommends not including any unrecovered Hydro-Québec Arbitration expense in Citizens' rate base.

We find Citizens' arguments supporting a five-year recovery period to be unpersuasive. The Board has previously approved a variety of different amortization periods. For example, in Docket No. 3758, the Board set a ten-year recovery period for extraordinary start-up costs.<sup>139</sup> On the other hand, in Docket No. 3744, the Board permitted CVPS to use a three-year amortization period for rate case expenses. In more recent orders the Board has allowed a five-year recovery period and a seven-year recovery period in setting amortization schedules.<sup>140</sup> Clearly, the fact that the Board has previously approved a five-year amortization schedule for some past deferrals does not mean a five-year amortization period is automatically appropriate for Hydro-Québec Arbitration costs. Instead, we find the Department's argument that recovery of the Hydro-Québec Arbitration costs should be recovered over the remaining life of the Hydro-Quebec Contract, which is 10 to 18 years, to be reasonable.

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138. Docket Nos. 6460/6120, Order of 6/26/01, Order at 39–40.

139. Docket No. 3758, Order of 2/19/75 at 9. The Order specifically cautions that the allowed amortization of these expenses, and the methodology required, should not be considered a precedent for similar expenses in the future.

140. Docket No. 6107, Order of 1/23/01 at 99–100.

Using a ten-year amortization period results in \$56,743 in rate year Hydro-Québec Arbitration amortization expense, leaving an unamortized balance of \$510,690.<sup>141</sup>

With regard to the correct treatment of the unamortized balance of the Hydro-Québec Arbitration expense, we disagree with the Department's recommendation. The Department has not contested the amount of the Hydro-Québec Arbitration costs that Citizens has incurred but not yet recovered, nor has the Department contested that Citizens should recover the full amount of these costs since some reasonable settlement of the arbitration proceeding might well have reduced Citizens' above market costs for purchases from Hydro Quebec. To exclude these costs from rate base would deny the Company the opportunity for full recovery of these expenses because of the carrying costs to the Company determined by its cost of capital. Instead, we agree with Citizens that it is necessary to include the unrecovered costs in rate base in order for the Company to recover the full amount of the costs. Therefore, we include the unamortized balance of \$510,690 of Hydro-Québec Arbitration costs in Citizens' rate base.

#### **D. Docket No. 6332 Expense**

##### **Findings**

109. Citizens deferred and has not begun to amortize \$172,096 in Docket No. 6332 rate case expenses which were incurred in 1998–1999. Tr. 4/5/02 at 172 (Doherty); tr. 4/9/02 at 167–69 (Cohen); tr. 4/9/02 at 197–199 (Schultz).

110. The May 31, 2000, Memorandum of Understanding signed by Citizens and the Department settling Docket No. 6332 does not preclude Citizens from seeking future recovery of costs it incurred in that rate case. Docket No. 6332, Order of 9/21/00.

111. The deferred costs should be reduced by \$1,593 to remove costs which should have been booked below the line, but which were incorrectly coded by Citizens and included in the deferred balance. Schultz reb. pf. at 30.

112. Included in the deferred Docket No. 6332 rate case expense are \$74,689 in external legal fees and expenses. Exh. DPS-HWS-2 at page 2 of Schedule C-5 revised.

113. A three-year amortization period for rate case expense is appropriate. Schultz pf. at 35.

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141. Calculated from Doherty, Schedule B.13 net Hydro-Quebec Arbitration costs minus rate year cost of service recovery.

114. Commencing amortization of expenses related to Docket No. 6332 immediately upon completion of the proceeding when the costs were known would result in there being seven months of these expenses left to amortize in the year for which this proceeding is setting rates. Schultz reb. pf. at 29.

### Discussion

Citizens and the Department disagree over the appropriate treatment of \$170,503 in expenses incurred during the Company's last rate case, Docket No. 6332. Citizens' position is that the Memorandum of Understanding accepted by the Board in its September 21, 2000, Order in that docket left open the future recovery of these costs. Accordingly, Citizens is now seeking to begin recovery of these costs over a three-year period. The Department's position is that Citizens should have begun amortization of these costs immediately upon conclusion of Docket No. 6332, and thus would already have recovered 29 of 36 months of the costs. The Department is also contesting the inclusion of \$36,113 of legal costs, 50 percent of the total legal costs included in the deferred balance, on the basis that Citizens has not provided sufficient supporting documentation. (The Department also suggests that the Board may wish to consider disallowing these legal costs in the entirety for lack of support.) As a result of these two factors, the Department calculates an unamortized deferral balance of \$26,131, to be recovered in the rate year.

The Memorandum of Understanding clearly does not preclude Citizens from seeking recovery of expenses relating to Docket No. 6332.<sup>142</sup> Further, the September 21, 2000, Order approving the Memorandum of Understanding clearly states the limited purpose of the rate increase granted at that time:

The costs being recovered by the Company pursuant to this increase are for DSM expenditures and for service restoration efforts following a severe storm . . . .<sup>143</sup>

We thus conclude that Citizens is not precluded from seeking rate recovery of these costs in this docket. This leaves to be decided here the appropriate amount and timing of recovery.

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142. Exh. CCC-9 at 2-3.

143. Docket No. 6332, Order of 9/21/00 at 4.

First, we address the Department's recommended disallowance of \$36,113 in legal expenses. The Department recommends the disallowance since Citizens did not provide support for these costs in sufficient detail for it to determine if the work was rate-case-related, probation-related, or for general corporate purposes. For the reason outlined in Section VIII.B.3 of this Order — i.e., that the Company improperly denied the Department its right to review the supporting material for these costs — we conclude that 50 percent of Citizens' legal costs relating to Docket No. 6332 should be disallowed. This results in adoption of the Department's recommended disallowance of legal expenses of \$36,113.

With regard to timing, we similarly find merit in the Department's contention that Citizens was obligated to begin immediate amortization of its Docket No. 6332 rate case expenses. We do not accept Citizens' contention that these costs were extraordinary, and their extraordinary nature made their deferral appropriate. There is substantial Board guidance on the recommended method of treating rate case costs. This Board typically views rate case and regulatory expense as a recurring cost, and in calculating the appropriate level of costs to be included in rates for service, uses a rolling average of historic expense over three to five years, or a reasonable period of time.<sup>144</sup>

We thus conclude that it is appropriate to allow \$26,131 in the rate year cost of service to recover seven months of expenses incurred in Docket No. 6332. Recoverable Docket No. 6332 expenses have been adjusted to remove 100 percent of external legal expenses and a small amount of other costs which should have been booked below the line.

### **E. Docket No. 6596 Expense**

#### **Findings**

115. As of April 2002, Citizens had booked \$543,000 in costs incurred for this rate case. The above figure includes only \$1,930 of the Department's costs for this proceeding. Tr. 5/20/02 at 174 (Cohen).

116. As of the time of Citizens' rebuttal testimony, the Department had issued bill-back notices for this case totaling \$180,205. Cohen reb. pf. at 8.

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144. See Docket No. 5702, Order of 5/17/95 at p. 22.

### Discussion

Citizens is requesting recovery of \$692,900 in costs associated with this proceeding, to be amortized over three years. The Department is recommending a \$25,000 reduction to this amount, to \$667,900. The Department is basing its recommended disallowance on Citizens' failure to provide documentation supporting its claim of legal expenses.

In this instance, we disagree with the Department witness's contention that actual review of legal bills is necessary to confirm the absence of probation costs in the expense totals relating to this docket. The case is still in process and thus Citizens could not have provided the Department with actual bills to review. We further note that the Company and the Department combined have already spent over \$723,205 on this proceeding. We conclude that amortizing \$692,900 in costs related to this proceeding over three years is reasonable. Thus, we are including one-third, or \$230,967, in amortization expenses in the rate year cost of service.

### **F. 1999 Storm Costs**

#### Findings

117. Citizens deferred \$506,470 in 1999 storm costs related to a windstorm in early July and Hurricane Floyd in September of that year. Kellogg pf. at 12; Shultz reb. pf. at 15; tr. 4/7/02 at 130 (Doherty).

118. Storm costs in 1999 were ten times the average annual costs of the prior four years, excluding 1998 ice storm costs. Exh. DPS-20.

119. Financial Accounting Standard ("FAS") 71 permits deferral of costs to the extent that a utility has a reasonable belief that a recovery of such costs is probable. Doherty reb. pf. at 10.

#### Discussion

Citizens is requesting the five-year amortization of \$506,470 in deferred costs incurred to restore service after a severe windstorm and Hurricane Floyd. The Department contends that Citizens failed to obtain a Board accounting order allowing deferral of these costs and accordingly recommends a rate base reduction of \$405,176 and a reduction in the rate year amortization cost of \$101,294.

We do not accept the Department's claim that since Citizens did not receive approval from the Board to defer 1999's storm restoration expenses, these costs should be disallowed. The Board has previously allowed Citizens to recover extraordinary storm costs.<sup>145</sup> Therefore, it was reasonable for Citizens to believe that the Board would allow it to amortize extraordinary storm costs in the future, even without an accounting order specifically authorizing the deferral of the costs. Although we are concerned that extraordinary items be truly extraordinary, the magnitude of 1999 storm expenditures meets a reasonableness test for extraordinary treatment since they were over ten times normal annual storm costs. We thus conclude that it is appropriate to amortize these expenses over five years. Accordingly, we include \$405,176 in Citizens rate base for 1999's storm restoration expenses, and \$101,294 in the Company's rate year amortization costs.

### **VIII. OTHER COST OF SERVICE ISSUES**

#### **A. Reserve for Storm Costs**

##### **Findings**

120. Citizens expended \$14,932 on storm costs in 1996, \$9,994 in 1997, and \$38,087 in 1998 (excluding expenditures related to the ice storm). There were no storm restoration costs in 2000. Storm restoration costs in 2001 were \$19,179. Exh. DPS-HWS-1 at Schedule B-4; Schultz pf. at 16, 19.

121. Citizens calculated a five-year average of storm costs to determine the proposed rate year \$100,000 normal storm restoration regulatory reserve. The average included extraordinary 1999 storm costs of \$506,470, but excluded costs incurred following the 1998 ice storm. Tr. 4/5/02 at 134, 138–139.

##### **Discussion**

Citizens is proposing the establishment of a regulatory reserve of \$100,000 to reflect the costs of "normal" storm restoration efforts. The reserve would be accounted for similar to deferred income taxes. Under the Company's proposal, the test year would reflect a \$100,000

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145. Docket Nos. 5841/5859, Order of 6/16/97 at 77, 114, 118–119.

expense, and the rate base would reflect a deferred credit of \$50,000. As actual costs from major storms are incurred, a charge would be made to the reserve. Accordingly, the reserve balance would increase or decrease each year to reflect the net difference between the accrual and charges during the year.<sup>146</sup>

The Department is recommending a \$10,000 reduction in the Company's proposed regulatory reserve for annual storm cost restoration costs, decreasing the proposed reserve to \$90,000. The Department contends that Citizens should not defer and recover the extraordinary storm costs of 1999 while including these so-called extraordinary costs in a calculation of a reserve fund allocation for normal storm restoration.

We conclude that neither Citizens' nor the Department's position on establishing a storm reserve is appropriate for Citizens at this time.

First, other Vermont utilities do not have storm recovery regulatory reserve funds similar to that suggested by Citizens, and the Company has not provided sufficient justification to persuade us to adopt a different treatment here.

Next, Citizens storm recovery costs over the past seven years have exhibited a high degree of volatility. We agree that some form of normalization may be an appropriate method for dealing with such volatility. However, we do not view the most recent seven years of storm cost figures as providing a sufficient basis for establishment of a special reserve fund for storm restoration expenses. Further, the most recent seven year experience provides little guidance on the appropriate level of such a regulatory reserve fund, if one were to be established.<sup>147</sup> Accordingly, we are disallowing Citizens' request for a \$100,000 storm restoration fund.

## **B. Other Legal, Regulatory and Consultant Costs**

### **Findings**

122. In addition to its requested recovery of rate case costs associated with Docket No. 6332 and the current docket (discussed above in Sections VII.D and VII.E of this Order), the Company has requested recovery of \$240,667 associated with annualized legal, regulatory, and

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146. Schultz reb. pf. at 20.

147. In future rate cases, Citizens is encouraged to present evidence which will allow major storm recovery costs to be recovered through averaging.

consultant costs. That amount is based on test year 2000 actual costs, as adjusted. The majority of the test year costs are for local counsel, FERC counsel, external KPMG audit costs, and other external consultants. Cohen reb. pf. at 3, 4; exh. CCC-KLC-6; tr. 5/20/02 at 160–161 (Cohen).

### **1. Uncontested Costs**

#### **Findings**

123. Included in Citizens' requested \$240,667 are consultants' fees paid to RBH Consulting, Johnson Company, and Stone and Webster. Those costs, together with other miscellaneous costs, make up \$65,098 of the total \$240,667 requested. The Department recommends that Citizens be allowed to recover these \$65,098 of costs. Schultz reb. pf. at 27; exh. CCC-KLC-6.

#### **Discussion**

The Department does not contest recovery of the \$65,098 for consultant and miscellaneous costs. We find these costs to be reasonable, and accept the parties' agreement to include the costs in rates.

### **2. KPMG Audit Costs**

#### **Findings**

124. Citizens seeks to recover \$27,721 in KPMG audit costs as VED's share of KPMG audit costs for the corporation for the test year. VED's \$27,721 share of the KPMG costs was based on the test-year four-factor allocator. That allocator has since been revised twice, most recently to 0.54 percent. Cohen pf. at 4; exh. CCC-KLC-6; tr. 5/20/02 at 160–161, 174–175 (Cohen); tr. 5/21/02 at 162–163 (Schultz).

125. The KPMG audits are enterprise-wide. The auditors look at the Company's billing models and corporate cost-allocation process, the Company's integrated general ledger system and the Company's enterprise-wide payroll system. All of these systems affect Citizen's Vermont operations. These reviews are done on a sample basis and include review of items affecting VED, including deferred debits and credits and regulatory assets. Tr. 4/9/02 at 122–125 (Cohen); tr. 5/20/02 at 188 (Cohen).

126. An independent audit such as that performed by KPMG is required by the Securities and Exchange Commission to be filed with the Company's Form 10K. Tr. 4/9/02 at 115–116 (Cohen).

### Discussion

Citizens contends that the KPMG audit services are a necessary cost of doing business for a publicly traded company, and that they provide benefits to VED and its Vermont customers.<sup>148</sup> The Department asserts that VED's ratepayers have derived no benefit from the audit, in light of continuing irregularities with VED's accounts and a failure by KPMG to review VED's accounting procedures or otherwise respond to the Board's Order in Docket Nos. 5841/5859, in which the Board found serious, longstanding, and pervasive problems with Citizens' accounting. The Department also contends that, if the KPMG audit costs are allowed in VED's rates, those costs should reflect the current, lower four-factor allocation rate for VED.<sup>149</sup> Citizens observes that if the Board concludes the newer four-factor rate to be a known and measurable change, it can recompute VED's KPMG cost in a compliance filing.<sup>150</sup>

In Docket Nos. 5841/5859, the Department raised essentially the same argument that it presents here: that the costs of Citizens' external audit should be disallowed because VED ratepayers received no benefit. We rejected the Department's argument then, and we reach the same conclusion here, for the same reason.<sup>151</sup> The external audit costs are a necessary cost of doing business for a public corporation. Consequently, we will allow Citizens to recover VED's appropriate share of the KPMG costs in rates. The appropriate share, however, must be calculated according to the most recent four-factor allocation rate of 0.54 percent, because that represents a known and measurable change to the test-year allocation. Consequently, we will

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148. Citizens Brief at 96–97.

149. Department Brief at 90–93.

150. Citizens Brief at 96.

151. See Docket Nos. 5841/5859, Order of 6/16/97 at 66.

require Citizens to submit a compliance filing that recomputes VED's share of the test-year KPMG costs using the 0.54 percent rate.<sup>152</sup>

### **3. Outside Counsel Costs (Other than Rate Case Costs)**

#### **Findings**

127. The Company included in its rate request \$147,849 in test year expenses for outside counsel.<sup>153</sup> This figure is based on amounts paid during 2000 to Eggleston & Cramer, Ltd., which is the Company's local counsel (\$88,546), and to Venable Baetjer & Howard, LLP, ("Venable") which is the Company's FERC counsel (\$59,172). In addition, a small amount (\$131) was paid to a third law firm. Exh. CCC-KLC-6.

128. Citizens provided affidavits of local and FERC counsel stating that probation-related costs were booked in separately identified matters and that counsel reviewed the non-probation-related matters and confirmed that these matters did not reflect probation-related activities. Exh. CCC-KLC-7; exh. CCC-KLC-8; tr. 5/20/02 at 84–87 (Cohen).

129. Citizens provided the Department with only redacted copies of invoices to support the test year expenses for outside counsel. Schultz reb. pf. at 27.

130. To resolve the dispute between the parties over the extent to which the Company's legal invoices are privileged, and pursuant to a motion made and granted during the course of rebuttal hearings, Citizens submitted unredacted legal invoices for *in camera* review by the Board's General Counsel. Memorandum of Kurt Janson, Board General Counsel, to Parties in Docket No. 6596, dated May 31, 2002 ("May 31 Memorandum").

131. Based on his *in camera* review, the Board's General Counsel concluded that the vast majority of entries in the legal invoices did not merit confidential treatment. He concluded that there was "no plausible claim of privilege for much of the material that Citizens has redacted from the attorney invoices." May 31 Memorandum at 2.<sup>154</sup>

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152. This revised calculation is not expected to have a material impact on the Company's revenue requirement, nor, accordingly, on its authorized rates.

153. As noted in the discussion below, the Company reduced this request to \$125,482, subsequent to the evidentiary hearings.

154. After Citizens filed a motion for reconsideration, the Board affirmed the General Counsel's determination. Order of 6/24/02.

132. The *in camera* review found, *inter alia*, that

a substantial portion of the work that [Venable] has billed as [VED] "General Advice" is described in the invoices as related to Citizens' Arizona Electric Division, with no apparent connection to the VED. In addition, Venable has coded as VED General Advice other entries that do not specify whether the work was done on behalf of the Arizona or Vermont operations (or both).

May 31 Memorandum at 3.

133. The *in camera* review did not reveal "any costs that are clearly related to probation." However, "many of the entries describe a subject matter very generally, or not at all. Thus, for many entries the only basis for concluding that they are unrelated to probation is the general reference on the invoice identifying the non-probation matter to which the law firm billed the work." May 31 Memorandum at 2–3.

### Discussion

While the Company initially requested recovery of \$147,849 in non-rate case costs for outside counsel, it has recently reduced its request to \$125,282 to reflect the removal of three categories of costs. First, the Company has reduced its request by \$11,941, for two invoices that the Company could not locate — one Eggleston & Cramer invoice for \$9,055, and one Venable invoice for \$2,887. Second, the Company acknowledges that, as the General Counsel found, Venable had improperly assigned costs to VED that should have been allocated to the Company's Arizona Electric Division. Citizens filed a letter from Venable which asserted that \$9,519 of costs should have been assigned to the Company's Arizona operations rather than VED. Third, the Company has agreed to remove \$907 in local counsel costs related to a lawsuit brought by former employee James Avery against the Company.<sup>155</sup> The Company contends that its resulting request of \$125,482 for outside legal costs is reasonable, and is supported by the affidavits of its outside attorneys and by the General Counsel's *in camera* review of the invoices at issue.<sup>156</sup>

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155. Letter from Victoria Brown to Susan Hudson, 6/10/02; Citizens Brief at 98; Cohen reb. pf. at 5.

156. Citizens Brief at 98–99.

The Department recommends disallowance of the entire amount of outside (non-rate-case) legal expenses. The Department had requested supporting invoices from Citizens, but Citizens had only supplied copies with most substantive information redacted.<sup>157</sup> The Department contends that the Company has failed to put in place reasonable procedures to substantiate that probation-related costs have been excluded from those sought to be included in rates.

The Department asserts that the General Counsel's *in camera* review demonstrates that the legal invoices, and the attorneys' supporting affidavits, are not a reliable basis for setting rates, especially given that they were not subject to adversarial review. Consequently, asserts the Department, Citizens has failed to carry its burden of proof on the issue, and the Board should disallow the outside legal costs in their entirety.<sup>158</sup>

We conclude, first, that we must disallow completely the claimed costs for work performed by Venable. The General Counsel's *in camera* review demonstrated that a substantial amount of work that Venable billed as VED-related was, in fact, not so. The Company mounted a last-minute attempt to limit the consequences of Venable's billing inaccuracies by submitting a letter from Venable purporting to show that such non-VED costs totaled \$9,519. However, this new Venable letter is not in the evidentiary record, and has not been subjected to discovery or cross-examination.<sup>159</sup> Thus, while the record demonstrates that we cannot rely on Venable's invoices (or the affidavit from a Venable attorney) to accurately allocate costs to VED, we also cannot determine the extent to which inappropriate costs are included in the Venable invoices

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157. Schultz reb. pf. at 27–28.

158. Department Brief at 93–97.

159. We note, for example, that Venable has allocated a portion of common and/or non-specified costs to VED. It is not clear on its face, without further exploration, that the allocation methodology is appropriate.

that the Company has assigned to VED.<sup>160</sup> Given that Citizens bears the burden of proof,<sup>161</sup> we accordingly must disallow all of the Venable costs.

On July 11, 2002, Citizens filed a letter stating that Venable had discovered *an additional* \$956 of Arizona Electric Division costs that should be removed from VED's test-year legal costs. Given our decision to deny recovery of any Venable costs, this further reduction in claimed costs does not change the cost of service that we allow the Company to recover in VED's rates. However, the late discovery of yet more costs that Venable (and Citizens) had improperly assigned to VED further demonstrates the continuing unreliability of the Venable costs that Citizens does seek to charge to VED's ratepayers.

The remaining outside counsel fees relate to service provided by the Company's local counsel, Eggleston & Cramer (other than \$131 for a third law firm, for which costs Citizens provided no supporting documentation and which we accordingly disallow). Here, the affidavit from Citizens' local counsel is of much higher quality than that from Venable; local counsel provided a more thorough explanation of the nature of the legal work performed, and our *in camera* review of the invoices did not uncover any apparent misidentification of the matter to which the work was billed.

Nonetheless, we conclude that one-half of the Eggleston & Cramer costs should be disallowed. Citizens refused for many weeks to allow the Department to review these invoices, alleging that they would reveal material information about legal advice and litigation strategies. When the Department pressed upon this issue, during the course of rebuttal hearings Citizens moved for the Board to conduct an *in camera* review of its unredacted legal invoices, to resolve the dispute between Citizens and the Department over the extent to which the invoices were privileged. The Board granted the motion, and Citizens submitted unredacted legal invoices for

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160. It is the Company itself — and not Venable — that improperly charged Venable's Arizona-related costs to Vermont, despite entries in the invoices clearly indicating that the work was on behalf of the Arizona operations. To support its request for an *in camera* review of its legal invoices, the Company asserted that "Citizens requires its outside counsel to provide detailed legal bills." Citizens' Motion for In-Camera Inspection and Order at 2. While it is appropriate (indeed, necessary) for the Company to demand that invoices for its outside services contain sufficient detail for it to properly review and assign the costs, it is troubling that the Company would then ignore that information. It is even more troubling that the Company, having ignored this information for accounting purposes, would then cite its importance to this Board for the purpose of precluding review by the public advocate.

161. *In re Central Vermont Public Service Corp.*, 769 A.2d 668, 678 (Vt. 2001); Docket No. 5132, Order of 5/15/87 at 79–89; Docket No. 5532, Order of 4/2/92 at 19.

*in camera* review by the Board's General Counsel, "in support of [the Company's] requests to recover costs related to (1) the 1999 rate case (Docket No. 6332) (Eggleston & Cramer invoices only) and (2) test year 2000 legal costs."<sup>162</sup> The General Counsel determined that the Company's assertion of privilege for the invoices was greatly over-broad, such that only a very few of the invoices merited confidential treatment. In our review of the General Counsel's *in camera* determination, we concluded that:

Citizens has fallen not just short, but far short, of making a good-faith attempt to segregate those billing entries that might arguably be privileged from the substantial portion that could not conceivably reveal any privileged material.<sup>163</sup>

As a result, the public advocate was denied its right to review the withheld, but actually nonprivileged, material upon which the Company was relying to support its requested cost recovery. Thus, the underlying documentation of the Company's costs has not been subject to adversarial scrutiny, due solely to the failure of the Company to disclose nonprivileged relevant information. Because the Company failed to comply with its discovery obligations and instead raised a wholly unsupported claim of privilege, we disallow one half of its requested costs for local counsel as a sanction pursuant to V.R.C.P. 26 (which applies to Board proceedings, pursuant to Board Rule 2.214).<sup>164</sup> As the Company's final request included \$78,584 of Eggleston & Cramer costs,<sup>165</sup> we allow recovery of one half, which amounts to \$39,292.

#### **4. Conclusion**

For the reasons stated above, we allow recovery in rates of the following legal, consultant and regulatory costs:

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162. Letter of Victoria J. Brown to Clerk of the Board, dated 5/27/02 at 1.

163. Order of 6/24/02 at 5 (footnote omitted).

164. We have inherent authority to enforce the discovery requirements of Rule 26 by excluding evidence or other appropriate action. *Greene v. Bell*, 171 Vt. 280, 283 (2000); *White Current Corporation v. Vermont Electric Cooperative, Inc.*, 158 Vt. 216, 223 (1992). We find that under the present circumstances, the reasonable range of sanctions would include the exclusion of the Company's evidence on this issue, which would result in a total disallowance of its costs for local counsel. We exercise our discretion to impose the lesser sanction of disallowing one half of those costs.

165. As noted above, the Company reduced its original request of \$88,546 by \$9,055 to reflect a missing invoice, and by an additional \$907 to remove costs associated with the Avery lawsuit.

Uncontested consultant costs and miscellaneous expenses	\$65,098
KPMG audit costs (subject to compliance filing)	27,721
Outside counsel costs	39,292
TOTAL	<u>\$132,111</u>

### **C. Probation Payroll Costs**

#### **Findings**

134. Citizens must pay the full costs of its probation, and none of the costs may be recovered in VED's retail rates. To assure that this condition is satisfied, "Citizens must keep complete, accurate, and reliable records of its costs in complying with this probation, including all direct, indirect, overhead, and allocated costs." Docket Nos. 5841/5859, Order of 9/15/98 at 72.

135. Citizens generally does not require a salaried employee to track time spent on probation-related activities, unless an entire day is spent on such activities. Tr. 4/9/02 at 158 (Cohen); tr. 4/8/02 at 21–22 (Kellogg).

136. Based on June 2001 payroll expenses, Citizens' pro forma annual payroll is \$2,005,452 for 52 employees. Exh. DPS-HWS-2 at Schedule C-7.

137. To correct for the Company's failure to allocate to probation expense a portion of salaried staff time, it is appropriate to reduce salary expenses by \$40,495.<sup>166</sup> Another \$2,835 in associated payroll taxes and \$10,124 in welfare and pension expenses should also be disallowed. Schultz reb. pf. at 25.

#### **Discussion**

The Department is recommending a \$40,495 reduction in Citizens' payroll expense to assign a value to the time spent by Vermont Electric Division staff on probation-related activities. The Department is recommending additional disallowances of \$2,835 and \$10,124 to account for payroll taxes, and welfare and pension costs, respectively, associated with the disallowed payroll costs. Citizens' position is that payroll costs should not be adjusted for any

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<sup>166</sup> Calculated using an average per employee payroll expense of \$38,566, multiplied by seven employees. 15 percent of the resultant total is \$40,495.

time spent by salaried personnel on probation-related activities since there was no incremental payroll costs associated with these activities.

Citizens' reasoning is unpersuasive. The terms of probation clearly state that Citizens is required to keep complete, accurate and reliable records of its probation costs, direct and indirect, including overhead.<sup>167</sup> It follows that some adjustment to payroll costs and associated taxes is required to correct for the Company's failure to assign a portion of payroll expense to probation-related costs, which are treated below the line for ratemaking purposes. The Department's recommended disallowances are estimates based on assumptions that seven salaried workers spend an estimated 15 percent of their working hours on probation activities.<sup>168</sup> We recognize that this estimate is a "best guess". However, given that Citizens did not have the records to justify another figure, the lack of written guidance on when time spent on probation-related activities should be separately recorded, and the evidence in the record that between 5 and 10 salaried employees may be assigned to probationary work, the Department's calculation appears reasonable.<sup>169</sup>

We are thus reducing Citizens' requested payroll expense figure of \$2,005,452 by \$40,495. Due to the payroll allocation, we are similarly reducing the Company's payroll tax cost figure of \$140,391 by \$2,835, and its welfare and pensions expense total of \$493,363 by \$10,124.

#### **D. Test-Year Revenues**

##### **Findings**

138. Citizens' original tariff filing used recorded revenues as the starting point for the test year revenues calculation. Exh. CCC-1 at Schedules C.A. and C.A.1.

139. In Citizens' last fully-litigated rate case, the Company used actual billing determinants from the test year for each customer class, and applied them to rates currently in effect, to determine the revenues it would receive based on current rates. Docket Nos. 5841/5859, Order of 6/16/97 at finding 141.

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167. Docket Nos. 5841/5859, Order of 9/15/98 at 72.

168. Schultz reb. pf. at 23-25.

169. Tr. 4/5/02 at 88 (Christensen).

140. In this case, Citizens should use actual billing determinants from the test year for each customer class, and apply them to rates currently in effect, to determine the revenues it would receive based on current rates. Schultz pf. at 25, 27.

141. Test year revenues are \$599,906 higher when actual billing determinants multiplied by current rates, rather than recorded revenues, are used as the starting point. Exh. CCC-1 at Schedule C; exh. DPS-HWS-1 at Schedule C-1.

142. The basic components of the revenue requirement calculation should be based on the same time period. Because Citizens' test year expenses are based on amounts recorded for calendar year 2000, and rate base is based on an average of December 31, 1999, and December 31, 2000, balances, its revenues should also be based on calendar year 2000 (adjusted to annualize the revenue impact of the rate increase in February 2000). Schultz pf. at 24.

143. Citizens' removal from revenues of the difference between the unbilled revenue balance as of December 31, 2000, and the balance as of December 31, 1999, causes a mismatch between revenues, expenses, and rate base. In addition, it ignores both customer growth that occurred during the year, and the effect of the February 2000 rate increase on the amount of unbilled revenues. Schultz pf. at 24–25.

144. Citizens' original tariff filing included a \$1,463 increase to residential revenues to reflect the delay in renewing the Company's special contract with LaBranche Lumber Company. This adjustment should have been made to commercial revenues, rather than residential revenues. Schultz pf. at 23; Doherty reb. pf. at 2.

### Discussion

Citizens and the Department disagree regarding the appropriate methodology for determining test year revenues. Citizens proposes starting with the Company's year 2000 recorded revenues,<sup>170</sup> while the Department proposes starting with actual billing determinants from the test year multiplied by the rates now in effect.<sup>171</sup> Citizens asserts that the Department's approach overstates revenues because it assumes that all customers received service for the full

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170. Doherty reb. pf. at 2, 15.

171. Schultz pf. at 25.

year (no partial monthly charges) and that no adjustments to customer bills were needed.<sup>172</sup> The Department notes that these explain why recorded revenues are different than actual billing determinants multiplied by current rates, but claims that these do not address why it is not appropriate to use, on a going forward basis, actual billing determinants multiplied by current rates.<sup>173</sup> Both parties assert that their recommended approaches are reasonable because the difference between them is less than one percent of total revenues.<sup>174</sup>

In Citizens' last fully-litigated rate case, it used the approach recommended by the Department in this case. That is, Citizens started with actual billing determinants multiplied by current rates to determine the revenues it would receive based on current rates.<sup>175</sup> Not only has Citizens failed to persuade us that it should use a different approach in this case,<sup>176</sup> but the Company failed to comply with Public Service Board Rule 2.402(B) which requires a utility to inform the Board when it uses a different ratemaking methodology than the Board approved in the utility's last rate case.<sup>177</sup> Therefore, Citizens' test year revenues should be increased by \$599,906 to reflect the use of actual billing determinants multiplied by current rates as the starting point in the revenue calculation.<sup>178</sup>

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172. Doherty reb. pf. at 15–16.

173. Schultz pf. at 26.

174. Doherty reb. pf. at 13; exh. CCC-1 at Schedule E.3; Department Brief at 79–80.

175. Finding 141 in the Board's June 16, 1997, Order in Docket Nos. 5841/5859 states: "To determine the revenues that it would receive based on current rates, Citizens used actual billing determinants from the test year for each customer class, and applied them to rates currently in effect."

176. We note that the Department's witness stated that most Vermont utilities use recorded revenues as the starting point in rate year revenue calculations. Tr. 5/21/02 at 225–226 (Schultz). This statement is factually incorrect. First, as shown by Finding 141 in the Board's June 16, 1997, Order in Docket Nos. 5841/5859, Citizens has not used this approach in the recent past. Second, based on our knowledge and expertise regarding ratemaking practices in Vermont, we know that most other electric utilities also use actual billing determinants multiplied by current rates, rather than recorded revenues, as the starting point in rate year revenue calculations.

177. Public Service Board Rule 2.402(B) states:

Where a request for a change in rates proposes or utilizes any change in the ratemaking methodology or principles approved or utilized by the Board in the most recent rate order affecting the same utility, such change shall be clearly identified, and a statement of the reasons for such change shall be given.

178. This number is calculated as follows: Recorded residential, commercial, industrial, public authority, and street lighting revenues for calendar year 2000 were \$26,616,700. Exh. CCC-1 at Schedule C. Those same revenues calculated using actual billing determinants and current rates would be \$27,216,606 (not including the \$1,463 increase to commercial revenues to reflect costs associated with the delay in renewing Citizens' special contract with LaBranche Lumber Company; this proposed adjustment is discussed below). Exh. DPS-HWS-1 at Schedule C-1.

(continued...)

Citizens and the Department agree that, regardless of the starting point, Citizens' test year revenues should be increased by \$1,463 to reflect the Company's delay in renewing its special contract with LaBranche Lumber Company. They also agree that Citizens' original tariff filing incorrectly shows this as an increase to residential revenues, and it should be an increase to commercial revenues. This adjustment is reasonable and we hereby approve it.<sup>179</sup>

Citizens and the Department disagree regarding whether there should be an adjustment for the difference between unbilled revenues as of December 31, 2000, and December 31, 1999. Citizens asserts there should be such an adjustment because unbilled revenues are an estimate calculated on the basis of a single period and it is more appropriate to use a 12-month level of actual revenues.<sup>180</sup> The Department disagrees, asserting that such an adjustment (1) results in a mismatch between the time periods used for test year expense, rate base, and revenues, and (2) ignores customer growth during the test year, as well as the effect of the February 2000 rate increase on unbilled revenues.<sup>181</sup>

The Department's arguments are compelling. Rates should be based on expected revenues and expenses for the same time period. The Company's proposed adjustment violates this basic ratemaking principle. In addition, because of customer growth and the February 2000 rate increase, we would expect the unbilled revenues for the second half of December 2000 to be higher than the unbilled revenues for the second half of December 1999. This does not mean that the higher number is less valid; rather, it means just the opposite — the higher number is likely to be a better approximation of revenues in the adjusted test year under current rates. Therefore, there is no need to make an adjustment to Citizens' test year revenues to reflect the difference between unbilled revenues as of December 31, 2000, and December 31, 1999.

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178. (...continued)

The difference between these two numbers is \$599,906.

We note that \$356,470 of this amount can be attributed to the annualization of the February 2000 rate increase. Citizens has conceded that the annualization adjustment is appropriate. Doherty reb. pf. at 2. Therefore the disputed amount of this adjustment is \$243,436.

179. We note that Citizens' error in recording the \$1,463 as an increase to residential revenues rather than commercial revenues does not change test year revenues.

180. Doherty reb. pf. at 16; exh. CCC-1 at Schedule C.1.1.

181. Schultz pf. at 24–25.

We note that the Department asserts test year revenues should be increased by \$137,713 to reverse Citizens' proposed adjustment.<sup>182</sup> We deny this proposed adjustment because our earlier determination renders it unnecessary. The Company's unbilled revenue adjustment was made to recorded revenues. We have already determined that actual billing determinants multiplied by current rates should be the starting point. No adjustment for unbilled revenues has been made in that calculation, so there is no need to reverse one.

### **E. Uncontested Issues**

#### **Findings**

145. The following Cost of Service Revenues were not contested by either party:

<u>Description</u>	<u>Source</u>	<u>Amount</u>
Dusk to Dawn Lights	Line 6–8 <sup>183</sup>	\$ 149,080
Wheeling Revenues	Line 9	1,059,136
Rental Income	Line 10	2,814
Other Revenue	Line 11	<u>151,741</u>
<u>Total</u>		<u>\$1,362,771</u>

Exh. DPS-HWS-2 at page 1 of Schedule C revised.

146. The following Cost of Service Expenses were not contested by either party:

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182. Exh. DPS-HWS-1 at Schedule C-1.

183. These line numbers refer to the line numbers on exhibit DPS-HWS-2 at page 1 of Schedule C revised.

<u>Description</u>	<u>Source</u>	<u>Amount</u>
Customer Accounting	Line 17 <sup>184</sup>	\$ 306,373
Insurance	Line 21	22,771
Injuries and Damages	Line 22	62,761
Rents	Line 24	84
Telephone	Line 25	104,503
Property Taxes	Line 31	895,289
1998 Extraordinary Storm Costs	Line 34	435,978
Pre-1999 DSM Costs	Line 36	1,370,980
Y2K Costs	Line 39	35,845
Amortization of Income Tax Credit/RSGM	Line 47	<u>(43,199)</u>
<u>Total</u>		<u>\$3,191,385</u>

Exh. DPS-HWS-2 at page 1 of Schedule C revised.

147. The following originally contested Cost of Service Expenses were later agreed to by the parties:

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184. These line numbers refer to the line numbers on exhibit DPS-HWS-2 at page 1 of Schedule C revised.

<u>Description</u>	<u>Source</u>	<u>Amount</u>
Purchase Power Costs	Citizens Brief at 105	(\$1,074,711)
Legal, Regulatory and Consultant Expenses	Citizens Brief at 98	(21,460)
Mergers and Acquisition* <sup>185</sup>	Tr. 4/8/02 at 186–187 (Mason)	(1,869)
Legal Expense – Avery*	Tr. 4/8/02 at 186 (Mason)	(508)
Legal Expense – Tow*	Tr. 4/8/02 at 186 (Mason)	(437)
Credit Cards – Tow*	Tr. 4/8/02 at 186 (Mason)	(54)
DAO CIP Expense*	Citizens Brief at page 2 of Appendix C	(810)
DAO Depreciation*	Tr. 4/8/02 at 186 (Mason)	(14,888)
PSO CIP Expense*	Citizens Brief at page 2 of Appendix C	(44,213)
PSO Depreciation*	Tr. 4/8/02 at 185 (Mason)	(7,345)
Tree Trimming	Exh. DPS-HWS-2 at page 2 of Schedule C revised	(71,000)
Account 923*	Exh. DPS-HWS-2 at page 2 of Schedule C revised	(8,175)
Administrative Office*	Citizens Brief at 93	<u>(48,827)</u>
<u>Total</u>		<u>(\$1,294,297)</u>

Citizens Brief at page 2 of Appendix C.

### Discussion

The parties are in agreement that test year power costs should be set at \$20,375,289. The \$3,800,000 disallowance proposed by the Department in connection with the Hydro-Québec Contract is discussed in Section IV.A, above.

The parties are in agreement that \$550,000 represents an appropriate level for costs related to tree trimming. Board Rule 3.600 (Maintenance of Electric Rights of Way) requires Citizens to report annually to the Board the actual funds expended for tree trimming. These annual reports will help the Board track whether Citizens does, in fact, spend \$550,000 annually on tree trimming.

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185. The sum of adjustments tagged "\*" equals the Administrative Office adjustment shown on exhibit DPS-HWS-2 at page 1 of Schedule C revised (at Column B, Line 19).

The Board finds reasonable, and thus accepts, the uncontested and agreed-to cost-of-service adjustments, as presented in the above findings.

## **IX. OTHER (UNCONTESTED) ISSUES**

### **A. Rate Base Issues**

#### **Findings**

148. The following Rate Base Costs were not contested by either party:

<u>Description</u>	<u>Source</u>	<u>Amount</u>
Contribution-in-Aid-of- Construction	Line 4 <sup>186</sup>	(\$6,625,796)
Materials and Supplies	Line 6	283,964
Pre-1999 DSM Costs	Line 8	3,541,698
1998 Extraordinary Storm Costs	Line 9	1,126,276
Y2K Costs	Line 14	<u>143,381</u>
<b>Total</b>		<b><u>(\$1,530,477)</u></b>

Exh. DPS-HWS-2 at page 1 of Schedule B revised.

#### **Discussion**

The Board finds reasonable, and thus accepts, the uncontested rate base costs.

### **B. Adjusted Test Year**

Citizens' original filing requests a rate increase effective December 15, 2001, and uses an adjusted test year of calendar year 2001.<sup>187</sup> The Department, in its Memorandum in Opposition to Request for Temporary Rates, states that the use of this adjusted test year is inappropriate because the proposed adjusted test year would be almost (if not entirely) in the past. According to the Department, this would violate Vermont law which requires the adjusted test year to be a period in the immediate future.<sup>188</sup> In the Department's testimony, it used an adjusted test year of

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186. These line numbers refer to the line numbers on exhibit DPS-HWS-2 at page 1 of Schedule B revised.

187. Hieber pf. at 18.

188. Department Memorandum in Opposition to Request for Temporary Rates, 12/21/01 at 4–5.

the period in which rates will be in effect.<sup>189</sup> The Company, in its rebuttal testimony, accepts an adjusted test year beginning in July 2002.<sup>190</sup> We find that the principle articulated by the Department is correct — the adjusted test year should be the period in which rates will be in effect. Therefore, the adjusted test year in this case is July 15, 2002, through July 14, 2003.

## X. COST OF CAPITAL

### Findings

149. Citizens and the Department have agreed that an appropriate capital structure to use to set rates in this proceeding is comprised of 50 percent debt and 50 percent equity. Letter dated 2/7/02 from G. Commons, Department of Public Service to S. Hudson, Board Clerk.

150. During the rate year, an appropriate cost of debt is 7.1 percent. The appropriate cost of equity is 11 percent. *Id.*

151. The return-on-equity penalty imposed in Docket Nos. 5841/5859 reduces Citizens' allowable return on equity by 525 basis points, to 5.75 percent. *Id.*

### Discussion

Although Citizens originally filed testimony as to the appropriate cost of capital and relative proportions of the capital structure, the Company and the Department reached an agreement that provides for a capital structure comprised of equal parts debt and equity. The two parties further agree that an appropriate cost of debt is 7.1 percent, and the appropriate equity cost is 11 percent. The 11 percent allowed return on equity is reduced to 5.75 percent after imposition of the return-on-equity penalty imposed in Docket Nos. 5841/5859. This capital structure, cost of debt, and cost of equity as adjusted are all reasonable, and we accept the resultant 6.425 percent cost of capital for the purposes of establishing rates in this proceeding.<sup>191</sup>

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189. We note that at least one Department witness appears to have used July 1, 2002, through June 30, 2003 (*see*, Shultz pf. at 3–4), while at least one other Department witness appears to have used July 15, 2002, through July 15, 2003 (*see*, Chernick pf. at 5). We find that this two-week difference does not materially affect the Company's costs in the adjusted test year, or the Department's proposed adjustments to the test year.

190. Hieber reb. pf. at 14.

191. There appears to be no dispute that this is the correct test year because neither party addressed the issue in its brief.

## **XI. CUSTOMER SERVICE ISSUES**

### **A. Service Quality and Reliability Plan**

#### **Findings**

152. The Department has proposed a Service Quality & Reliability Performance, Monitoring & Reporting Plan ("Plan") for Citizens.<sup>192</sup> The Plan includes specific performance measures in seven broad areas of service that have a substantial impact on consumers: call answering; billing; meter reading; work completion; customer satisfaction; worker safety; and reliability. Frankel pf. at 5; exh. DPS-DLF-1.

153. The Plan requires Citizens and the Department to negotiate minimum performance standards and make any necessary refinements to the measurement process, reporting, protocols, and methods of data collection. The Plan provides for the results of this negotiation to be submitted to the Board for approval by October 1, 2002. Frankel pf. at 4; exh. DPS-DLF-1 at 1.

154. The Plan requires Citizens to file corrective action plans if quarterly performance falls more than ten percent below any standard, or if performance does not meet any standard for two consecutive quarters. These corrective action plans must be filed within 30 days of the end of the quarter in which the provision is triggered. Exh. DPS-DLF-1 at 3.

155. The Plan would remain in effect for two years following Board approval of the minimum performance standards. Frankel pf. at 8; exh. DPS-DLF-1 at 1.

156. The Plan requires Citizens to negotiate with the Department and submit to the Board for approval a successor plan no later than 90 days prior to the expiration of the Plan. The Plan requires that the successor plan include financial penalties and/or incentives tied to performance. Frankel pf. at 8–9; exh. DPS-DLF-1 at 1.

157. The Plan requires Citizens to propose, to the greatest extent possible, customer service guarantees permitting the waiver of fees for services not provided on a timely basis. Exh. DPS-DLF-1 at 2.

158. The Plan's framework is generally consistent with the framework of the service quality plans that the Board approved for Green Mountain Power Corporation and Central Vermont Public Service Corporation. Frankel pf. at 4.

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192. The Plan was admitted into evidence as exhibit DPS-DLF-1, and is attached to this Order as Appendix C.

159. It is anticipated that there will be differences between Citizens' data collection systems and those of CVPS and GMP. It may be necessary to make adjustments to the Plan to accommodate those differences. Frankel pf. at 4.

160. The implementation of service quality plans similar to the Plan benefit consumers because they (1) are more comprehensive than utilities' current service monitoring practices, (2) supply public information on the level of service a company is providing, (3) supply data that can be used to make comparisons between utilities, (4) establish a database which can be used to set future, more stringent targets, (5) include fee waivers for missed service appointments, (6) include expected financial penalties in the plan to be adopted after two years, (7) allow companies to identify and fix any problems that are revealed as a result of the measuring and reporting functions, and (8) help verify that any incentives to cut costs do not cause a deterioration in service. Frankel pf. at 3.

### Discussion

Section 219 of Title 30 requires electric utilities (and other regulated utility companies) to "furnish reasonably adequate service, accommodation and facilities to the public." Vermont law gives this Board the authority to set standards regarding this utility obligation. Specifically, 30 V.S.A. § 209(a)(1) gives this Board jurisdiction over "[t]he . . . quality of any product furnished or sold by any company subject to supervision under this chapter," and 30 V.S.A. § 209(a)(3) provides jurisdiction over "[t]he manner of operating and conducting any business subject to supervision under this chapter, so as to be reasonable and expedient, and to promote the safety, convenience and accommodation of the public . . . ." Taken together, these statutory provisions establish the basis for service quality and reliability standards by which the adequacy of service can be measured in order to determine whether a company is, in fact, providing "reasonably adequate service" and is operating its business in a "reasonable and expedient" manner that "promotes the safety, convenience, and accommodation of the public."

The Department has proposed that the Board approve a service quality plan for Citizens (the Plan). The Plan includes performance standards in seven broad areas:

- Call answering;
- Billing;

- Meter reading;
- Work completion;
- Customer satisfaction;
- Worker safety; and
- Reliability.

How the standards will be measured, as well as the baseline for each standard, will be determined through negotiation between the Company and the Department, in a process described in the Plan. Once the minimum performance standards are established, the Plan requires Citizens to file corrective action plans if quarterly performance falls more than ten percent below any standard, or if performance does not meet any standard for two consecutive quarters.

As crafted, the Plan provides for Citizens to waive its service fees, to the greatest extent possible, when the Company fails to meet designated commitments for performing those services. This is a first step to tying financial incentives to the provision of quality service. The Plan also provides that a successor plan will be negotiated that will include financial penalties and/or incentives tied to performance.

Citizens does not contest the establishment of a service quality plan for itself, and is willing to work with the Department to negotiate the details of such a plan.<sup>193</sup> Citizens did not present any evidence against approval of the Plan, although it did raise questions regarding the cost of implementing the Plan, especially the cost of conducting the customer surveys called for in Section C.5 of the Plan. In response to those questions, the Department indicated that the cost of implementing the Plan could not really be determined until the Department and Citizens had negotiated the process for measuring the specified performance standards, but the Department believed Citizens' data collection systems would not need significant changes, except for the addition of the customer surveys.<sup>194</sup> The Department also stated that in its negotiations with

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193. Citizens Brief at 124; Citizens Reply Brief at 31.

194. Tr. 4/10/02 at 138–139, 144 (Frankel).

other electric companies, it has endeavored to minimize the cost of implementing their service quality plans.<sup>195</sup>

In general, the Plan's framework is substantially similar to the service quality plans for GMP and CVPS that the Board approved in their respective rate cases.<sup>196</sup> In those cases, the Board found that those service quality plans provide significant benefits to ratepayers, including more comprehensive service monitoring, supplying public information on the level of service a company is providing, the establishment of a database from which to set future, more stringent targets, the waiver of fees for missed service appointments, and expected financial penalties in the successor plan to be adopted after two years.<sup>197</sup> Since the Plan is similar to GMP's and CVPS's plans, we find that the benefits provided to Citizens' ratepayers will be similar to those provided to GMP's and CVPS's ratepayers. We recognize, however, that there are unresolved issues regarding the details of implementing the Plan, including the cost of implementing it. Therefore, we approve the Plan, with the caveat that the October 1, 2002, filing required by the Plan may include changes to the Plan's framework if necessary to accommodate Citizens' data collection systems or to reduce the cost of implementing the Plan. However, we require Citizens to explain the reasons for any such changes, and to specifically address whether the changes affect the benefits provided by the Plan to consumers.<sup>198</sup>

In addition, consistent with the practice established by the Board in earlier dockets implementing service quality standards, we require Citizens to file the monitoring reports referred to in Paragraph 1 of Section B of the Plan, and the corrective action plans referred to in Paragraph 4 of Section B of the Plan, with the Board in addition to the Department.

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195. Tr. 4/10/02 at 139 (Frankel).

196. *See*, Docket No. 6107, Order of 1/23/01 at 87–90, and appendices pages 26–36, and Docket Nos. 6120/6460, Order of 6/26/01 at 43–46.

197. *See*, for example, Docket Nos. 6120/6460, Order of 6/26/01 at 45.

198. We consider the Plan's framework to include all items specified in the current version of the Plan. Minimum performance standards are not included in the current version of the Plan and therefore are not part of the framework. Citizens and the Department do not need to explain the reasons for establishing minimum performance standards. However, Citizens and the Department should be prepared to explain why those levels are appropriate for Citizens, particularly if any minimum performance standards are outside the range which the Board has previously approved for other electric utilities.

**B. Interpretation of Board Rule 3.307(B)****Findings**

161. Board Rule 3.307(B) states:

The company shall restore service if the disconnected customer pays one half of the delinquent bill, or a lesser negotiated amount, before restoration and enters into a repayment plan to pay the balance over a minimum period of three months, except that the company is not obligated to enter into more than two plans of this type with a particular customer within a given year.

Board Rule 3.307(B).

162. Board Rule 3.302(D)(4) states: "Any customer who applies for the plan [budget billing] and has a delinquent balance shall have the right to pay for the delinquency in an extended repayment plan concurrent with the budget plan." Board Rule 3.302(D)(4).

163. In the past, Citizens has interpreted the Board's rules as allowing a customer to select budget billing as a payment option up to the point of disconnection, but not after. Allen pf. at 2.

164. In general, Board Rule 3.307(B) should be read in conjunction with Board Rule 3.302(D)(4) to allow a disconnected customer to go on the budget billing plan and spread any delinquent balance over twelve months rather than the three-month repayment period set forth in Rule 3.307(B). However, if the Company can document that it had attempted to place the customer on budget billing with a twelve-month repayment plan in the past, but the customer either declined to accept the arrangement or had not kept to the repayment plan, the Company should be allowed to require that arrearages be paid in three months. Allen pf. at 3; tr. 4/10/02 at 160–161 (Allen).

**Discussion**

In the past, Citizens has not offered budget billing to disconnected customers. However, the Company has agreed to change its practices and offer budget billing to disconnected customers, with the caveat that if Citizens can document that it had attempted to place the customer on budget billing with a twelve-month repayment plan in the past, but the customer either declined to accept the arrangement or had not kept to the repayment plan, the Company

can require that arrearages be paid in three months.<sup>199</sup> This interpretation of the Board's rules is reasonable, and we hereby require Citizens to change its practices accordingly.

## **XII. REVISIONS TO TARIFFS**

### **A. Request for Waiver of Board Rule 3.202(B)(2)**

#### **Findings**

165. Board Rule 3.202(B)(2) states:

Interest on each deposit shall be calculated using a simple interest formula using the rate prescribed under subdivision (B)(1) that existed on the date the deposit is made. That rate shall be applied to the entire term of the deposit, up to twelve months. For example, if a customer deposit were made on the first of December, the interest rate for the ensuing twelve months would be the interest rate calculated under subdivision (B)(1) during the calendar year the December deposit was made.

Board Rule 3.202(B)(2).

166. At the time this docket was opened, Citizens had a request pending before the Board for a waiver of that portion of Board Rule 3.200 which requires that the interest rate in effect on the date a customer makes a deposit remain in effect for at least 12 months for that customer. The reason for the waiver request was that Citizens' billing system could not accommodate the requirement to change the interest rate on the anniversary of the payment of the deposit and therefore use different interest rates for different customers on the same date. Exh. CCC-DPL-4 at 9; tr. 4/5/02 at 50 (Lahar).

167. Since filing its original waiver request, Citizens has implemented a new customer information system. This new system is also unable to change the interest rate on the anniversary of the payment of the deposit for the same reason. Lahar reb. pf. at 13; tr. 4/5/02 at 50 (Lahar).

168. Citizens' billing system is capable of adjusting the deposit interest rate annually, when the Board-approved interest rate changes, and applying the new rate to all customers' deposits. Lahar reb. pf. at 13; tr. 4/5/02 at 50 (Lahar).

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199. Citizens Brief at 125.

169. The revised tariffs filed by Citizens on June 28, 2002, incorporate a waiver of Board Rule 3.202(B)(2). The Department does not object to the waiver. Letter from Geoffrey Commons, Esq., Department of Public Service, to Susan M. Hudson, Clerk, Public Service Board, dated July 5, 2002.

### Discussion

Because of limitations in its customer information system, Citizens has requested a waiver of that portion of Board Rule 3.200 which requires that the interest rate in effect on the date a customer makes a deposit remain in effect for at least 12 months for that customer. While Citizens' initial request for a waiver referred to the limitations of a system already in place when the portion of Board Rule 3.200 governing the determination of the interest rate on deposits was changed, Citizens has acquired a new system since the rule change went into effect. We are concerned that when Citizens acquired this new system, it did not make sure that the system would enable Citizens to comply with Vermont's regulatory requirements then in effect (including the portion of Board Rule 3.200 at issue here). Nevertheless, Citizens has proposed a reasonable alternative, to which the Department has not objected. Therefore, we grant Citizens' requested waiver and its alternative method of determining the deposit interest rate: Citizens will adjust its deposit interest rates annually on January 1, and apply the new rate to all customers' deposits.

## **B. Other Tariff Changes**

### Findings

170. The revised tariffs filed by Citizens on June 28, 2002, include many language changes designed to clarify inconsistencies or minor errors, correct out-of-date information, and eliminate ambiguities that currently exist. The revised tariffs also:

- (1) modify the rates, terms, and conditions for street lighting service (service classification #4);

(2) increase the amount charged for non-sufficient-fund checks from \$5.00 to \$10.00 to more accurately reflect the associated cost of service; and

(3) specify the amount of the charges customers will incur in the following situations: suspension of service; disconnection of service due to non-payment; reconnection of service; and continuous service.

Lahar pf. at 9; tr. 5/21/02 at 15 (Lahar); June 28, 2002, tariff revisions, *generally*.

### Discussion

On June 28, 2002, Citizens filed revised tariffs that include numerous proposed language changes and reflect the Company's requested rate increase. The discussion that follows addresses the proposed language changes, but not the rates included in the revised tariffs. Those rates will be modified to reflect the Board's determination that the Company is entitled to an increase of 17.45 percent above existing rates.

On July 5, 2002, the Department notified the Board that it does not oppose any of the proposed language changes.<sup>200</sup>

Most of Citizens' proposed changes clarify existing policies or remove out-of-date information. We find these changes improve the readability of Citizens' tariffs and hereby approve them.

A few proposed changes are more substantive. First, Citizens proposes to modify the rates, terms and conditions for street lighting service (service classification #4), including eliminating two of the nine currently available rates. At present, there are no customers served under either of these rates, and the elimination of these rates is part of the Company's effort to convert its street light system to more efficient types of street lights.<sup>201</sup> We are pleased Citizens is eliminating the use of inefficient older types of street lights, and approve the changes related to the rates, terms and conditions for street lighting service.

Second, Citizens proposes to increase the amount charged for non-sufficient-fund checks from \$5.00 to \$10.00. When performing rate design, we try to establish rate structures under

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200. Letter from Geoffrey Commons, Esq., Department of Public Service, to Susan M. Hudson, Clerk, Public Service Board, dated July 5, 2002.

201. Tr. 5/21/02 at 16-17 (Lahar).

which customers who cause the costs pay for them. Citizens has not changed its fee for non-sufficient-fund checks in many years<sup>202</sup> and we find that an increase to \$10.00 will more accurately reflect the associated cost of service. Therefore, we approve this proposed change.

Finally, Citizens proposes to specify the amount of the charges customers will incur in the following situations: suspension of service; disconnection of service due to non-payment; reconnection of service; and continuous service. Some of these changes are clarifications of the existing tariff language while others are modifications. As stated above, we support the principle of charging customers for the costs they cause the Company to incur. We find that the proposed charges are reasonable for types of services provided, and we hereby approve these changes.

In sum, we approve all the proposed language changes in Citizens' June 28, 2002, revised tariff filing, with the caveat noted above that the rates will be modified to reflect the Board's determination that the Company is entitled to an increase of 17.45 percent above existing rates.<sup>203</sup>

### XIII. CONCLUSION

In this Order, we approve a retail rate increase of 17.45 percent (or \$4,776,369), effective for service rendered on or after July 15, 2002. In addition, we approve a service quality plan designed to assure high quality electric service for Citizens' Vermont consumers. Overall, we conclude that the resulting rate levels are fair to Citizens' ratepayers and the Company.

As part of today's decision, we do not find that Citizens was imprudent in committing to the Hydro-Québec Contract in the early 1990's because of circumstances that distinguish it from other Vermont electric utilities. However, we do find that the Hydro-Québec Contract is used but not economically useful in the rate year, despite the Contract's unique benefits for Citizens that have increased the value of the power to Citizens and its Vermont ratepayers. Therefore, we disallow \$750,000, which is one-half of the above-market costs of the Contract in the rate year.

Finally, we express our deep dissatisfaction with Citizens' continued accounting problems, and announce that we may reevaluate whether any accounts should be treated

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202. Exh. CCC-DPL-4 at 8.

203. This figure may be adjusted slightly to reflect a compliance filing that we require of the Company.

differently for rate purposes (on a prospective basis) when we review Citizens' probation in Docket Nos. 5841/5859.

#### **XIV. ORDER**

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. Citizens Communications Company ("Citizens") is entitled to rates that will produce additional revenues in the amount of \$4,776,369 or 17.45 percent above current rates, as may be adjusted to reflect the compliance filing required in Paragraph 2, below, for service rendered on or after July 15, 2002.

2. Citizens shall recompute the Vermont Electric Division's ("VED") share of the test-year KPMG audit costs using a four-factor allocation rate of 0.54 percent, shall reflect the results in the compliance filing required in Paragraph 3, below, and shall file this recomputation when it files the compliance filing.

3. Citizens shall file revised tariffs with this Board and the Department in conformance with the above findings and conclusions within five (5) days of the issuance of this Order.

4. Citizens shall conduct a full depreciation study and file the results with the Board by December 31, 2005. If VED does not have sufficient data for a full study to be conducted by this date, Citizens shall notify the Board as soon as possible, and no later than April 15, 2005.

5. Citizens shall file a clear and neutral request for a Private Letter Ruling from the Internal Revenue Service on the proper treatment of accumulated deferred income taxes given that, as a result of the settlement agreement regarding the MRI Audits, plant account balances were reduced but accumulated depreciation balances were not. The request shall include the reason for the adjustments to plant account balances, namely, that Citizens failed to properly maintain its plant accounts. Citizens shall submit the request to the Internal Revenue Service within 45 days of the issuance of this Order and shall obtain the agreement of the Department on the form and content of the request before submitting it.

6. Within 60 days of the issuance of this Order, Citizens shall update its demand-side management database to accommodate VED's new account numbers. Citizens shall inform the Board and the Department when this update has been completed.

7. By October 1, 2002, Citizens shall file a Final Service Quality & Reliability Performance, Monitoring & Reporting Plan ("Final Plan") as described in Paragraph 2 of Section A of the Service Quality & Reliability Performance, Monitoring & Reporting Plan ("Plan") attached hereto as Appendix C. The Final Plan may modify the Plan's framework if such changes are necessary to accommodate Citizens' data collection systems or to reduce the cost of implementing the Plan. However, if the Final Plan includes any changes to the Plan's framework, Citizens shall explain the reasons for the changes and address whether the changes affect the benefits provided by the Plan to consumers.

8. Citizens shall file the monitoring reports referred to in Paragraph 1 of Section B of the Plan, and the corrective action plans referred to in Paragraph 4 of Section B of the Plan, with the Board in addition to the Department.

9. Citizens shall offer budget billing to disconnected customers. However, if Citizens can document that it had attempted to place the customer on budget billing with a twelve-month repayment plan in the past, but the customer either declined to accept the arrangement or had not kept to the repayment plan, Citizens shall be allowed to require that arrearages be paid in three months.

10. Citizens' request for a waiver of Board Rule 3.202(B)(2) is granted. Citizens shall adjust its deposit interest rates annually on January 1, in accordance with the interest rate formula in Board Rule 3.200. Citizens shall then apply the new rate to all customers' deposits.

11. The revised tariffs filed by Citizens on June 28, 2002, are approved in their entirety, except that the rates therein shall be modified in accordance with Paragraphs 1 and 2, above.

12. All findings and conclusions requested by the parties and not specifically adopted above are, hereby, rejected.

Dated at Montpelier, Vermont, this 15th day of July, 2002.

s/Michael H. Dworkin )

) PUBLIC SERVICE

s/David C. Coen )

) BOARD

s/John D. Burke )

) OF VERMONT

OFFICE OF THE CLERK

FILED: July 15, 2002

ATTEST: s/Susan M. Hudson

Clerk of the Board

*NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)*

*Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.*

**Appendix A — Schedule of Hearings**

Public Hearings

February 19, 2002 at North Hero, Vermont, and  
February 20, 2002, at Newport, Vermont

Technical Hearings

April 5, 8, 9, 10, and 11 and  
May 20, 21, 22, 23, 24, 2002, at Montpelier, Vermont

**Appendix B — Parties**

Vermont Department of Public Service

represented by: Geoffrey Commons, Esq.

Citizens Communications Company d/b/a Citizens Energy Services

represented by: Victoria J. Brown, Esq.  
Gary L. Franklin, Esq.  
Scot L. Kline, Esq.  
Eggleston & Cramer, Ltd.

**Appendix C — Service Quality Plan**

RECOMMENDED CITIZENS ENERGY SERVICES  
SERVICE QUALITY & RELIABILITY  
PERFORMANCE, MONITORING & REPORTING PLAN

**Section A: General Provisions**

1. The purpose of this plan is to establish performance standards, and performance monitoring and reporting for electric service provided by Citizens Energy Services (“CES” or “the Company”) in all its Vermont territories. The plan shall be referred to throughout this document as the “Plan.”
2. Section C of the Plan establishes performance areas, in which CES shall establish, monitor and report minimum performance standards. The Company shall negotiate with DPS to establish binding minimum performance standards and make any necessary refinements to the measurement process, reporting protocols and methods of data collection no later than October 1, 2002, which shall be referred to as the “Final Plan.” If the method of data collection required to report on the performance standard has longer lead time to implement, the Company shall negotiate with DPS a specific date in which they will be able to collect the necessary data and establish the minimum performance standard. The Final Plan shall be submitted on or before October 1, 2002, to the Vermont Public Service Board (“PSB”) which may, after opportunity for hearing, impose any minimum performance standards in areas where the parties' negotiations were unsuccessful. The PSB may, at its discretion, require modification of any performance measures which were not yet established in this Plan.
3. The Final Plan, following negotiation of all performance standards, shall remain in effect for two years from the date of approval by the PSB. No later than 90 days prior to the expiration of the Final Plan, CES shall negotiate with DPS, and submit to the Board for approval, a successor plan, which shall include financial penalties, and/or incentives tied to performance.
4. Notwithstanding the provisions of Section A, Paragraph 2, nothing in this Plan shall preclude the use of any other remedies available under law for addressing substandard performance.
5. In the event that CES opens its territory to retail choice during the life of this Plan, the parties acknowledge additional and/or different standards may be necessary to monitor service delivery changes attendant to restructured service delivery. CES shall negotiate with DPS additional standards should the need arise. Modifications to the Plan under this paragraph shall be submitted to the PSB for approval.
6. Notwithstanding the provisions of Section A, Paragraph 3, this Plan and its minimum performance standards to be negotiated in accordance with Section A, Paragraph 2 shall,

to the greatest extent possible, include customer service guarantees permitting the waiver of fees for services not provided on a timely basis. CES shall file such tariff amendments as are necessary to implement negotiated service guarantees, and such guarantees shall not be effective unless the PSB grants tariff approval.

7. In addition to the performance standards and measurements set forth in this document, CES shall adhere to the following time frames for response to consumer and regulatory complaints:
  - a. CES shall provide a substantive response to consumer complaints expressed directly to the company within 14 calendar days of receipt by any method of contact.
  - b. CES shall provide a substantive response to consumer complaints from DPS within 14 calendar days.
  - c. If CES needs additional time to respond fully to a complaint from a consumer or from DPS, the Company shall within the initial 14-day period request a specific additional time for response and shall provide a full resolution within the requested additional time.

#### Section B: Measurement, and Reporting Protocol

1. CES shall continue to monitor performance in areas in which it has an established data collection method and reporting protocol. All other performance monitoring will commence in accordance with this plan, on October 1, 2002. Reporting periods shall be calendar quarters, with quarterly reports submitted to DPS by the last day of the month following the end of each quarter, except for overall customer satisfaction, worker safety and reliability performance measures, which shall be developed for the calendar year, with reports submitted by January 31 of the following year. If the performance monitoring commences before the final Board Order is issued, the parties agree to modify as necessary the performance monitoring plan in order to bring it into full compliance with the final Board Order.
2. Except as provided in Section B, Paragraph 1, performance results shall be aggregated monthly and quarterly, and shall be reported quarterly to the DPS. The parties shall jointly develop an electronic reporting format.
3. Quarterly reports shall include both monthly and quarterly averages. Quarterly and 12-month averages shall be derived from raw data, not by averaging monthly averages. Achievement of minimum standards shall be determined on the basis of a 12-month rolling average updated quarterly. A minimum performance standard shall be considered met if, in each quarter's reporting, the 12-month rolling average met or exceeded the standard.
4. Notwithstanding Paragraph 3, where quarterly performance falls more than ten percent below any standard, or where performance does not meet any standard for two consecutive quarters, CES shall, within 30 days of the end of the quarter in which this

provision is triggered, submit a corrective action plan indicating how it will remediate the failed standard.

5. Performance shall be evaluated and reported to one decimal place for all performance areas unless otherwise specified. Actual performance shall be rounded up when the second decimal place is 5 or more. CES shall retain all of its reports that support the results for each of the performance areas for a period of not less than 24 months after the results are reported. CES shall provide these reports upon request to DPS.
6. CES shall review with the DPS any change to CES's measurement protocol or to the internal reporting methods that are used to obtain the data measured prior to CES's implementation of such changes. If the DPS and CES are unable to agree on the changes requested, nothing in this Plan shall preclude DPS from seeking appropriate relief from the PSB. CES shall have an affirmative duty to report missing data or other events that could reasonably affect the quality of the data at the time the Company becomes aware of such events. Any data related to the SQRP reported to DPS that reflects significantly altered measurement procedures or internal data acquisition methods that have not been agreed to between CES and DPS shall be subject to challenge and potential exclusion from results.
7. CES may seek a waiver of any applicable performance standard from the PSB. A waiver may only be granted based upon exceptional circumstances. The burden shall be on CES to demonstrate that its level of preparedness and response was reasonable in light of the cause of the failure.
8. CES and the DPS shall meet as needed to discuss service quality issues, trends in service quality data reported by CES, issues raised by customer complaints filed with the DPS, and other policy issues relating to customer service. CES shall initiate these meetings on a periodic basis with a goal of meeting no less than once every six months. Meetings may occur more frequently at either party's discretion. These meetings shall focus on customer service issues raised by customer complaints filed with the DPS and by other communications to the DPS from customers. The intent of these informal meetings is to exchange information in an open and frank atmosphere, to suggest pragmatic solutions, and solve problems.

### Section C. Performance Standards

1. **Call answer performance measures:**
  - a. Call Answering Service Level: Percent of customers reaching a company representative within 20 seconds during normal business hours. This standard tracks the percentage of attempted calls to successfully reach a company representative within 20 seconds during normal business hours

Number of all calls reaching a company rep within 20 seconds

Number of attempts to reach a company rep

This measure includes outage and business calls received during normal business.

- b. Abandon Rate: Percent of calls abandoned during normal business hours. This standard tracks the percentage of all attempted calls to reach a company representative during normal business hours that are abandoned after reaching CES's telephone system. It shall be calculated as follows:

$$\frac{\text{Number of all calls abandoned}}{\text{Total calls}}$$

This measure includes outage and business calls received during normal business hours.

- c. Abandon Rate: Percent of calls abandoned outside of normal business hours. This standard tracks the percentage of all attempted calls to reach a company representative outside of normal business hours that are abandoned after reaching CES's telephone system. The purpose of this standard is to track off-hours outage calls. It shall be calculated as follows:

$$\frac{\text{Number of all calls abandoned}}{\text{Total calls}}$$

This measure includes calls received during normal business hours, Monday through Friday, and 24 hours on weekends and holidays on which CES offices are closed to normal business.

- d. Blocked calls: Percent of customer blocked (reaching a busy signal). This standard tracks the number of customer calls which reach a busy signal thus preventing customer from reaching CES's Call Center. It shall be calculated as follows:

$$\frac{\text{Number of customer calls receiving a busy signal}}{\text{Total number of calls to Call Center}}$$

2. Billing performance measures:

- a. Percent of bills not rendered monthly. This standard tracks the percentage of bills not rendered monthly. This standard shall be reported to the third decimal place. It shall be calculated as follows:

$$\frac{\text{Number of bills not rendered for the billing month}}{\text{Total number of bills rendered for the billing month}}$$

- b. Percent of bills found inaccurate. This includes all bills that are determined to be inaccurate as result of a customer complaint and all bills that are found to be inaccurate by the company after the bill has been sent to the customer. It shall be calculated as follows:

$$\frac{\text{Number of bills rendered inaccurately for the month}}{\text{Total number of bills rendered for the billing month}}$$

- c. Satisfaction with payment posting. This standard is defined as the combined rate of complaints regarding the speed of payment posting per thousand customers expressed directly to the Company and to DPS. It shall be calculated as follows:

$$\frac{\text{Number of customers complaining about payment posting speed}}{\text{Total number of customers}/1000}$$

3. **Meter reading performance measures:**

- a. Percent of actual meter readings per month: This standard tracks the percentage of meters actually read each month in relation to the number that were scheduled to be read. It shall be calculated as follows:

$$\frac{\text{Number of meters read}}{\text{Number of meter readings scheduled}}$$

4. **Work completion performance measures:**

- a. Average days to completion of a line extension from the date the customer is ready. This standard tracks the percent of line extensions completed from the time the customer is ready. Performance shall be calculated as follows:

$$\frac{\text{Total days to complete line extensions minus exclusions}}{\text{Number of line extensions completed}}$$

- b. Percent of customer requested work completed on or before promised delivery date: This standard tracks the percentage of jobs resulting from customer requests for meter related or other customer requested work that is completed on or before the promised completion date. Performance shall be calculated as follows:

$$\frac{\text{Number of jobs completed on or before promised date}}{\text{Total number of jobs completed}}$$

- c. Average delay days for missed delivery date: This standard tracks the average number of days of delay for the completion of meter related or other customer

requested work that is completed on or before the promised completion date. Performance shall be calculated as follows:

$$\frac{\text{Total days of delay}}{\text{Total number of delayed jobs}}$$

5. Customer satisfaction measures:

- a. Percent of customer satisfaction following customer-initiated contact with the company (report, request, inquiry, complaint). This standard tracks the level of customer satisfaction following direct interaction with a CSR or other company representative resulting from a customer-initiated contact. Using an independent, third-party contractor, CES shall survey post-transaction a statistically reliable sample of customers who have contacted the company with a report, request, inquiry or complaint to assess level of satisfaction with the transaction. This survey will be conducted quarterly starting in the third quarter of 2002. The questions, explanatory information, and method of surveying, as well as the minimum performance levels, shall be negotiated in accordance with Section A, Paragraph 2.
- b. Percent of customers satisfied following completion of customer requested work. This standard tracks the level of customer satisfaction following customer-requested work completed by CES. Using an independent, third-party contractor, CES shall survey post-completion a statistically reliable sample of consumers who have had customer requested work completed by the company to assess level of satisfaction with the work performed. This survey will be conducted quarterly starting in the third quarter of 2002. The questions, explanatory information, and method of surveying, as well as the minimum performance levels, shall be negotiated in accordance with Section A, Paragraph 2.
- c. Percent of all customers satisfied with the company: This standard shall be measured once annually. Using an independent, third-party contractor, CES shall survey a statistically reliable sample of the company's Vermont customers to assess general customer satisfaction. The wording of questions, the explanatory information provided, sample size, and the method of surveying, as well as the minimum performance level, shall be negotiated in accordance with Section A, Paragraph 2.

6. Worker safety performance measures:

- a. Lost Time Incidents: Lost time incidents are the total number of incidents in a calendar year that: (1) cause an injury to an employee; and (2) occur while the employee is performing work for the utility; and (3) result in the employee missing work beyond the day of the injury.

- b. Lost Time Severity: Lost time severity is the cumulative number of work days missed by employees in a calendar year, resulting from injuries sustained by the employees while performing work for the utility.

7. Reliability Performance Measures:

- a. System average interruption frequency ("SAIFI"). This standard is defined in Public Service Board Rule 4.901 and shall be established for the system as a whole.
- b. Customer average interruption duration ("CAIDI"). This standard is defined in Public Service Board Rule 4.901 and shall be established for the system as a whole.
- c. Worst-Performing Areas. For each calendar year, CES shall identify the ten worst performing circuits on its system, identify the factors underlying the performance of these circuits, and institute economically feasible measures to improve the reliability of these circuits. All circuits which have been identified shall be monitored each year, over a five-year period, to determine the effectiveness of the improvement measures and to identify any further measures that may be required.
- d. Major Storms. Calculation of the SAIFI and CAIDI indices shall be net of outages caused by major storms. A major storm is defined as a severe weather event that satisfies all three of the following criteria:
  - i. Extensive mechanical damage to the utility infrastructure has occurred;
  - ii. More than 10% of the customers in a service territory are out of service due to the storm or the storm's effects; and
  - iii. At least 1% of the customers in the service territory are out of service for at least 24 hours.